

Community Associations: How to Draft Documents That Work

WAYNE S. HYATT*

No community association—whether for condominium, PUD, or other development—will work unless it operates under documents that allow it to perform a myriad of managerial and governmental roles. This article tells how to draft such documents; what factors to consider in fitting the documents to a particular project; and how to solve such problems as complying with applicable statutory law, defining boundaries, assigning percentages, transferring control from developer to unit owners, reserving easements, providing for use, access, and maintenance, and association powers and procedures.

The drafting of documents for condominium and homeowners associations (HOA) should be seen as part of a dynamic process, an essential step in creating a project that will be successful not only during marketing, but also, and perhaps more important, during the project's operational life. The challenge is to draft "documents that work" so that the development will work.

The emphasis in much of what has been written about condominium and homeowners associations has been on what the association is, how to market units, how to appraise units, or how to avoid liability.¹ But the more fundamental question is how the

* Wayne S. Hyatt is a member of the Bars of Georgia and the District of Columbia. He received his B.A. and J.D. degrees from Vanderbilt University, and is a partner in the Atlanta law firm of Hyatt & Rhoads. He is actively engaged in the representation of condominium and homeowner associations and in advising and consulting with developers, lenders, and their attorneys regarding association affairs.

¹ Too often, attorneys use too many footnotes with the result that the most valuable notes are unread. In the interest of avoiding that result, I have not cited cases and other authorities. There are a number of publications to which indirect reference is made in the text and which can materially assist any reader who wishes to explore a question in more detail. They are: Hyatt, "Condominium and Home Owner Associations: Formation and Development," 24 Emory L.J. 977 (1975); Hyatt & Rhoads, "Concepts

project documents should be structured and, thus, how the association should function. How the documents are structured can and will affect the project and its operations in a variety of ways. The drafter must have an appreciation for the competing yet usually complementary interests and perspectives involved in a common-interest community. He needs sufficient expertise to deal with the total development picture, the ability to look at all points of view, and the determination to build in the checks and balances so necessary for the good of the project.

There are competing interests, and each interest involved is, of course, important, but no single interest should predominate. If the developer's or the lender's interest is protected at the expense of the ultimate purchaser-occupant, a number of obvious problems can arise: potential lender liability for development problems, chilling marketing, burdening association operations, and the like.

To understand the lender's interest one must be able to see all sides of the issue, for the lender is, or has the real possibility of being, the project evaluator, the construction financier, the unit mortgagee, the owner and seller of the project or a substantial part of it, and the owner through default of individual units. The lender's long- and short-term interests in the project thus combine to some extent those of lender, developer, and unit owner.

Drafting, then, must not so protect one interest as to burden unnecessarily the other interests. With these perspectives in mind, the documents should make the association work to provide the best protection for everyone.

Preliminary Considerations

What do I want to create? What will work best? What fits the site? These should be the drafter's first considerations. There are very real differences between a condominium and a homeowners association; the umbrella association, the community services as-

of Liability in the Development and Administration of Condominium and Home Owners Associations," 12 Wake Forest L. Rev. 915 (1976); Urban Land Institute/Community Associations Institute, *Managing a Successful Community Association* (2d ed. 1976); Urban Land Institute/Community Associations Institute, *Financial Management of Condominium and Home Owner Associations* (1975); Urban Land Institute/Community Associations Institute, *Creating A Community Association: The Developer's Role in Condominium and Home Owner Associations* (1976).

sociation, and the full panoply of associations and other components of a planned unit development also present choices in appropriateness and applicability.

To make these choices requires the combined efforts of a development team. The developer, attorney, architect and site planner, construction lender, permanent lender, title insurer, accountant, insurance agent, and advertising and sales agent all have major roles to play. While the team approach may appear expensive, it is worth the costs.

Concept of a Mandatory Membership Association

The team effort fails, however, if there is not an understanding of the unique concept of a mandatory membership association. The drafter, and indeed all involved in the development, must understand that an association performs two distinct roles, one managerial, the other governmental. Both are interrelated and are strengthened by the fact that everyone who buys a unit or a lot must be a member.

The association's first role is to manage its business; this includes the various service-oriented functions designed to benefit the membership, e.g., maintenance, insurance, water and garbage, security, and so on, as well as the unstated but equally important service of equity protection and enhancement benefiting the unit owner, developer, and lender. The association, generally a not-for-profit organization, either incorporated or unincorporated, has the same responsibilities as any other similar business and should be organized to operate as such.

The association's second role is governmental. This more subtle and sophisticated role involves the association's exercise of regulatory powers of a mandatory nature such as its power to assess and to file a lien. It is crucial that drafter, lender, lender's counsel, and developer all remember that an association does have significant governmental attributes and must have documents reasonably consistent with quasi-governmental powers and duties.

The Project's Peculiarities

Just as the same site plan or blueprints will not fit all projects, neither will the same documents. Many individual characteristics must be taken into consideration in the drafting process: the geography of the project, land characteristics (e.g., this author once

prohibited basements in a homeowners association because of a 5-foot water table), planned amenities, and demographics. As the people vary in background, interest, and experience, the documents must also vary. The drafter should visit the site to appreciate how the documents are a part of an overall development plan.

He should draft with a site plan on the floor beside his desk. Having seen the site, he can better keep in focus all the pieces and how they fit together. Most important, he should keep in mind that the documents are not an end in themselves but rather, as with the site plan, part of a dynamic process that must work and remain dynamic for years.

As part of the process of examining and understanding the project, the drafter should keep the gathering of information as a goal for himself and the dispensing of information as a goal for the documents. There are many questions about the operation of the project which the documents should answer for the buyer and unit owner. The documents should spell out, for example, the delineation of maintenance responsibilities, insurance provisions—including responsibility for deductibles—pets, parking, and so on. In defining common and limited common elements, the drafter is defining not only ownership but also maintenance responsibilities. He therefore must consider the broader impact of his decisions and ensure that the documents inform and enlighten rather than confuse.

Financing

The last preliminary consideration is financing. The construction and mortgage lenders' concerns must be respected as must those of the secondary mortgage market. One caveat, however, is appropriate. The requirements of the secondary mortgage market are clearly designed for lender protection and often result in a loss of individual owner participation in major decisions. Moreover, documents often contain form provisions even though the project will not and perhaps cannot be approved by the secondary market. The point is simple: Do not slavishly use forms, no matter whose forms they are.

A Declaration Is a Constitution

The crucial considerations for the development team to keep clearly in mind when reconciling their competing interests are that the completed documents must be *flexible, unique, and realistic*. If

these characteristics are present in the documents, they should work. The drafter should recognize that the declaration is not a mere contract bargained for among several parties but, rather, is very much a constitution although adopted, in the condominium context, in accordance with a statute. This "constitution" sets out the obligatory rights and duties of people who will live in the development years after the recording of the documents. The declaration and bylaws, therefore, must be flexible and realistic in anticipation of changes in time, personalities, and the residents' needs, desires, and abilities. They should be sufficiently unique in order to ensure that they fit the particular project.

Obviously, the drafter must anticipate that things may go wrong—for the association members, the developer, or the lender. He will have to build in some protective provisions that allow for flexibility in dealing with each contingency. Once again, however, the drafter must guard against protecting one interest group at the expense of the others.

Lastly, the planning for and the organizing of the association must be like the documents themselves: flexible, unique, and realistic. The special roles that the association fulfills necessitate more detailed planning and more skill in drafting than the bylaws often reflect. Perhaps this is due to the drafter's failure to understand the complexity and importance of these roles. That point brings us back to the beginning point of this discussion of basic drafting considerations and provides a good summary: The drafter must understand both the concept and the project and must draft with flexibility, uniqueness, and realism in mind.

Form and Format

Form is not the same as forms. The use of form documents can be disastrous, particularly when the form is not the drafter's. There is nothing wrong, of course, with using a form, so long as it is well tailored to reflect the basic considerations just discussed.

Mandatory Statutory Provisions

The documents must comply with the applicable statutory law—usually the applicable state condominium act. There are no state enabling statutes for homeowners associations (HOA); therefore, the drafter must be more careful and detailed. The condominium statutes vary in quality and detail. Essentially, the drafter has two

challenges. First and most obvious, the Declaration of Condominium must meet the requirements of the statute, and this may entail a careful review of many sections of the statute in order for the documents to reflect the permissive as well as the mandatory statutory sections.

The second task involves ensuring that gaps in the statutory scheme are plugged by the documents. Most state condominium statutes are extremely rudimentary, and reflect the state of the art in the early 1960s. The drafter must, whenever possible, cure these deficiencies by skillfully drafting provisions supplementary to but consistent with the basic statute. Hopefully, over the next year or two, many states will adopt the Uniform Condominium Act (UCA). In the meantime, drafters can use the UCA as a guide to the types of provisions that should be considered.

When the development will be an HOA, the drafter has no statutory framework upon which to rely and must be particularly careful. Provisions which might otherwise be taken for granted must be authorized in the Declaration of Covenants, Conditions, and Restrictions. For example, the association's lien rights and the delinquent owner's personal liability for unpaid assessments are statutory in the condominium context but are available in an HOA only if the drafter carefully creates both in the documents.

At the same time, the drafter must be aware of other statutory provisions that might affect the documents and must, in some cases, select among alternatives. For example, should the association be incorporated and what limitations, if any, should be placed on the corporate powers? In the HOA situation, the association is almost always incorporated because the association has title to the common property. Whether to incorporate at all, and if so, whether to incorporate as a profit or nonprofit corporation, and what powers to provide the corporation are all questions which must be answered on a project-by-project basis. Zoning, subdivision, tax, and other state and local laws or ordinances must also be considered for their impact on the development.

The Bylaws

In both the condominium and the HOA, the bylaws should contain the administrative provisions and should be more easily amended than the declaration, which contains provisions directly establishing or restricting property rights. The bylaws, unfortunately, are often simply reproductions of the bylaws found in a

"corporate kit" purchased in a legal stationery store. This is the wrong way to do the job.

The bylaws are not simply another item on the drafter's checklist; they are the rule book by which the association, and particularly the officers and directors, function. The bylaws can and should anticipate what effects the particular characteristics of the project—geography, amenities, construction style and materials, demographics, and so on—have on the association's business and governmental roles. Little things can mean a lot: an appropriate number of directors commensurate with the size of the project and the anticipated leadership pool; an indemnification provision; management standards; rule-making and hearing procedures; guidelines on whether and how the association may contract with association members; innovative methods of allowing unit owner involvement while protecting legitimate developer interests; realistic budgetary and assessment-setting procedures.

There is conflicting opinion on whether the bylaws should be recorded. In some states, of course, condominium bylaws must be recorded. When recording is not required, some attorneys argue that recording unnecessarily increases rigidity and the expense of amending. On the other hand, the bylaws contain important operational and administrative provisions. Requiring recording of the bylaws and any amendments provides notice to everyone what those provisions are and ensures that there will be at least one current, official copy. This, in the opinion of this author, is the better view.

The format of the documents has a great deal to do with whether they will be used and hence whether they are workable. There should be a table of contents and a sufficient number of headings and subheadings to facilitate easy use. The documents should be on letter-size paper so that they are easily filed and kept handy by nonlawyers. Documents on legal-size paper fit the legal file cabinets of attorneys but hardly of anyone else. The drafter should, wherever possible, avoid "legalese" and write in a style consistent with maximum understanding. The documents should be coherent, concise, and complete.

Specific Problem Areas

Having examined the basic considerations and the question of format, it is helpful to look at specific problem areas that are often

troublesome. This discussion is by no means exhaustive; it does, however, cover many "problem provisions."

Boundary Definitions

A fundamental, often mishandled, item is the setting of unit and property boundaries. Some condominium documents have used unit boundary definitions originally prepared for fee simple units in a homeowners association. Some documents have employed mutually exclusive definitions so that it is impossible to determine whether land is part of the common elements or is part of a unit. In another instance, the boundary of the entire tract was misdefined—in a ninety-one-unit condominium development, five of the ninety-one units were actually located on the developer-retained recreation tract. Originally the models, the unsubmitted units were sold as if part of the condominium, and the error was not discovered until the unit owners assumed responsibility for the association. These are typical illustrations of needless problems found in many documents. If the drafter takes the time to conceptualize what is being created and then makes the words fit the concept, boundary definitions can reflect no end of innovative development techniques. Otherwise, there can be a disaster. The designation of limited common elements is a companion problem. Unless expressly permitted by a "second generation" condominium statute or unless unanimous consent is obtained, limited common elements may not be assigned or reassigned after the original assignment nor may common elements be restricted for use by less than all owners. Such an assignment otherwise constitutes a taking of property. Again, however, this can be easily handled during drafting.

Assignment of Percentages

Equally basic is the assignment of the percentage of interest in a condominium. Some states' statutes are explicit on how the percentage should be computed, either by value, square footage, equally, or by some other method. Whatever method is used, the process must be carefully followed. It is not unusual for the total of the percentages to fall short of 100 percent or for documents to retain 10 percent or more "to be reassigned" as a control device. Except in a properly constituted expandable condominium, percentages, once assigned, are immutable, absent unanimous consent. Clearly, this is an item that should and can easily be done correctly the first time.

Transferring Control From Developer to Unit Owners

The drafter should carefully and honestly think through the question of developer control of the association. That thinking process should include answers to the questions "How?," "How long?," and "Why?" as they pertain to control. As the basic premise, the developer has legitimate interests to protect. However, total developer control of the association is very often not the best way to protect those interests, and it can lead to management headaches and potential liability.

The developer should also seek to involve the unit owners in a meaningful way in the association's operations, both to spread the risk and input on decisions and to start the training process for the time when the owners must assume full control. Innovative drafting can reconcile the various parties, protecting and enhancing the interests of both. For example, there are documents that turn board control over to the unit owners when 50 percent of the units are sold. The board then has full control subject to a veto in the developer. Both interests are protected, friction and direct developer involvement is reduced, and the board is able to obtain D&O liability insurance, currently unobtainable under developer control.

Reservation of Easements

Another provision that often results in difficulty for the association and the developer concerns retained development rights, particularly in regard to easements and phased construction. This provision is too often an afterthought and does not contain the flexibility necessary for the developer (or lender) to adjust to changing circumstances. The other side of the problem is a document so detailed and explicit as to constitute an enforceable affirmative covenant running with the land and requiring construction and development in spite of changed times. The overall plan, including the contingencies, must be a part of the drafting process; easements must be reserved, and the right but not the obligation to do certain things must be made clear. Obviously, that which will be done should be so indicated, and the sales representations must keep clearly separate the "will" from the "may."

The size of an association, its relationship to other associations in the project, the use of an "umbrella association," and how to add phases are all questions that must be considered.

Use, Access, and Maintenance

The use, access, and maintenance provisions are also quite important and yet are often "boiler plate." The use provision should clearly set out who may use what facilities and how. It should address the permitted uses of the unit or lot as well as the common elements, and should anticipate the fact that the developer might need or desire to retain reasonable rights to use facilities. The use provision needs to be both broad and flexible. It provides both a right of use and a power to limit or regulate use.

Access means more than just the necessary easements to the property. The more pressing concern is the question of access to all necessary parts of the property including, where appropriate, the units themselves. There has been litigation on this point, and the drafter must thoughtfully balance serious, competing interests.

The maintenance provision should answer the question of "Who does what for whom and who pays for it?" Clearly, concisely, and completely, the document should resolve these questions before they arise. The cost and other consequences of making the maintenance assignment must also be considered.

Creating Governing Powers and Procedures

The making and enforcing of rules and regulations is perhaps the most hotly contested area of association activity. There are a number of court cases from around the country on these issues. In these cases, the crucial considerations have been whether the board or the association (1) had the power to do what it did and, (2) whether the action taken was reasonable. The original power source for a condominium, of course, is the statute; however, for the condominium as well as the HOA, the declaration and bylaws both constitute a source of power and formulate a procedure for exercising that power. The specifics and scope of the regulatory process of the "mini-government" being created need to be carefully drafted after making a realistic appraisal of what the association will do and what the courts are requiring. While they may be quasi-governmental entities, associations clearly are not governments. They should not be burdened with the full administrative procedures, for example, that a municipality must observe.

Some process is due, however, and the constitutional concerns of due process, equal protection, and reasonableness must be built into the documents. Standards must be set, either in the documents or in accordance with them, to guide the enforcement body. Rea-

sonableness must be built into the practices, procedures, and processes created for the association. "Reasonableness" is the key word, for if the rule or decision is reasonable, it will generally be enforced.

"Reasonableness" is basically what the twelve good people sitting in the jury box say it is. It is what a person with commonsense would do or decide in the same or similar circumstances. It is the embodiment of fairness and equality. If the drafter creates documents with reasonableness, fairness, and enforceability in mind, especially in the rule-making and enforcement sections, the documents and the actions taken under them will pass muster.

Financial Management

Entire books have been written on the financial management of associations; most drafters would do well to read one. In spite of the fact that the FHA is currently wedded to the consumer price index as the measure for increasing assessments, this author still believes that such inflexible provisions place artificial and unreasonable restraints upon an association's proper exercise of its business functions.

The board should be authorized to develop a budget and set the assessment subject to the association's right of review and rejection. The board, officers, and finance committee should have the power and the flexibility to go with it. Associations with such workable, flexible provisions are exercising the financial management consistent with their business functions.

The documents should also provide realistically for reserves and capital budgets. Too often, documents give little or no guidance on this point. The reserve amount should be the reflection of a capital expense budget, and the process, rationale, and obligation should be created in the documents.

The developer should resist the temptation to write a self-exemption from assessments. There are grave statutory concerns in such a practice, and it is a red flag for the unit owners.

Right of First Refusal

Another provision that proves troublesome in practice is the "right of first refusal." Too often it is not used consistently, and there is a very real possibility of divisive and expensive litigation when it is used. If such a provision is included in documents, the

drafter should have considered and documented a purpose for the provision and should ensure that the provision itself is reasonable in scope.

Insurance

The insurance and indemnification provisions are too often so basic that the association has no guidelines on rebuilding, repair, appraisal, responsibility for deductibles and short falls, and a myriad of other issues. Insurance is essential, and the insurance and repair-restoration provisions need careful, knowledgeable attention from the perspective of the operations of the association. It is beyond the scope of this article to detail the ingredients of such provisions, but a drafter should look to the other available literature in order to make these provisions work.

There are of course other problem provisions. Among these are amendments, meeting and notice provisions, condemnation, architectural standards, and others. Each can be effectively drafted if the basic considerations outlined at the outset are kept in mind.

Conclusion

There are three basic mistakes that prevent documents from working. The first mistake is that in preparation—the failure to do the investigation and teamwork necessary to understand the project. One must develop a game plan and an outline, not only for the documents themselves but also for the association in its operation years after the last sale.

The second mistake is that in drafting. The rote use of forms increases both the probability and impact of this type of error.

The third, and perhaps most serious, mistake is a mistake in confidence—a failure to have sufficient confidence in the concept of common-interest communities and in the people who live in them. This results in a failure to build into the documents, and thus into the project, *involvement*, *procedures*, and *practicality*. It is, perhaps, the result of a negative reflex response to community associations. But community associations are inadequate only because of inadequate planning, creation, and administration.

Documents can—and do—work, and good documents start the process which, to everyone's ultimate benefit, makes community associations successful.