

Community Associations Update

OUR PROFESSIONALS



Jeffrey VanGrack
Co-Chair
Email
301-657-0159



Jason E. Fisher
Co-Chair
Email
301-657-0743



Christine N. Johnson
Email
301-657-0188

Welcome to another issue of the Community Associations Update, a bulletin published periodically by the Community Associations Practice Group at Lerch, Early & Brewer as a service to our clients. Here, you will find articles written by our attorneys covering a variety of current issues that affect the management of your Community Association.

This newsletter is sent via email in HTML format. If you wish to print a copy of the newsletter, you may access a .pdf version by following the "Printer-Friendly version" link below.

We appreciate any feedback and invite you to contact us via email at bjharris@lerchearly.com. If you do not want to receive any further newsletters from us, follow the link at the bottom of this email to be removed from our list of recipients.

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Conflicting Interests - What Board Members Should Know

SERVICE AS A MEMBER OF THE BOARD OF DIRECTORS OF A COMMUNITY ASSOCIATION BRINGS WITH IT SPECIAL DUTIES AND OBLIGATIONS. THUS, BOARD MEMBERS MUST ALWAYS BE AWARE OF THEIR DUTY OF LOYALTY TO THE ASSOCIATION THEY SERVE.

All board members owe their association a duty of loyalty, which is to act in good faith and to make decisions that are in the best interests of the association. Conflicts of interest are generally defined as situations that may cause the director to take an action or make a decision out of self-interest rather than the best interest of the association. These situations can deprive the owners of a neutral decision-making board.

An excellent illustration of such a conflict of interest is the case of the board member who happens to be a real estate agent of properties within the same association she serves. On the surface, having the neighborhood real estate agent serve on the board would seem like an ideal situation, as the interests of a seller's real estate agent often go hand-in-hand with the successful operation of a community. Yet those same shared interests could at times conflict with a board member's duty of loyalty to take actions that are in the best interest



Jeremy M. Tucker
Email
301-657-0738



Patrick L. O'Neil
Email
301-657-0738

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of the association.

For example, an issue could come before the board as to whether to raise assessments to fund reserves and/or to issue a special assessment, or whether to approve improvements to a property that may have detrimental or beneficial effects on an upcoming sale of a home. In this example, there is no clear conflict of interest as is the case where a board member seeks to award a contract to a family member. However, there is a pending decision before a board member that will have an impact on the financial status of the association and, possibly, on the sale of one of the board members' properties in the neighborhood. A situation such as this may cause the board member to make a decision out of self-interest.

When presented with this potential conflict, the conflicted board member must disclose the situation to the entire board and should not cast any votes on it if she could not make an impartial decision. While the law may not require a board member to do this, refraining from voting when there is a potential conflict ensures that there will be no question as to the board member's loyalty in decision making.

In sum, it is important for board members to be aware of and avoid, if possible, any situations that could present even the appearance of a conflict of interest. The most seemingly benign activities have the potential to become conflicts for board members and prevent them from following through on their duty of loyalty to their association.

This article originally appeared in the May 2006 issue of Quorum, the monthly newsletter of the Washington Metropolitan Chapter of the Community Association Institute.

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Change in Law Affecting Representation before the CCOC

EFFECTIVE OCTOBER 1, 2006, COMMUNITY ASSOCIATIONS MAY REPRESENT THEMSELVES WHEN APPEARING BEFORE THE COMMISSION ON COMMON OWNERSHIP COMMUNITIES.

The Maryland General Assembly, in its recently-concluded 2006 session, adopted a bill amending existing law to specifically authorize community associations to represent themselves in a dispute, hearing, or other matter before a board or a commission. The new law specifically allows the Association's Board members or Officers, in addition to an attorney, to appear and present the Association's case at a hearing before the CCOC or other board or commission. Previously, an attorney was required to represent a community association in such matters when the case reached the stage of a hearing. Although the law now permits an Officer or Director of the Association to represent the Association, Managers or other members of the association are still not permitted to do so. Such individuals, however, may still testify as a witness for the association.

While our office does not have an opinion as to whether an Association Board of Directors should represent themselves in such situations, Board members or Officers seeking to represent the Association may not have the background, knowledge, or experience to do so without proper legal training. At a minimum, the Board may wish to obtain guidance from its legal counsel before appearing and arguing at a hearing without representation.

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The Lease Addendum - An Overlooked Tool

QUITE POSSIBLY THE MOST EFFECTIVE AND OVERLOOKED TOOL IN THE BOARD'S ARSENAL TO REIGN IN UNRULY TENANTS IS THE LEASE ADDENDUM.

While recent growth in residential property values have created a boom for individual property investors, it has raised significant issues for community associations. Many Boards today grapple with the ever-increasing number of non-occupant owners and their sometimes problematic tenants, who either do not abide by the Association's covenants and restrictions or choose to ignore the rules and regulations. This is not to say that owners themselves do not sometimes flaunt the governing documents of an Association, but as highlighted here, the ability of the Association to hold the violator directly responsible is more difficult when the person is the tenant.

Problem tenants are those tenants who continually violate the Association's governing documents while failing to grasp the idea that they are living in a community that has rules above and beyond their lease. Often, associations are required to seek the assistance of the owner to enforce the tenant's compliance with the governing documents, with varying

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degrees of success. Unfortunately, most community associations do not make proper use of all tools that may be available to directly control or fully respond to the actions of these problem tenants.

Fortunately, one of the most effective and overlooked tools in the Board's arsenal to reign in these unruly tenants is a lease addendum. A lease addendum is a document specifically approved by the Board of Directors, executed by the Lessor/Owner and the Lessee/Tenant, and incorporated into the lease. A lease addendum can and should include language that specifically authorizes the Board of Directors to terminate a lease in the event of a tenant's breach of the governing documents. No longer would the Board be compelled to seek an Owner's assistance, whose interests may lie elsewhere, in trying to obtain compliance; they would be able to seek enforcement directly against the tenant as well.

The authority to implement a lease addendum is likely already contained in the community association's declarations or bylaws. A quick review of these documents should reveal the necessary language needed to authorize the adoption and use of a lease addendum, such as:

- "the Board may adopt a standard lease form,"
- "all leases shall be on a form approved by the Board of Directors," and/or
- "the Board may adopt Rules and Regulations regarding the actions of owners within their units."

If the use of a lease addendum is authorized, then proper drafting is necessary so as to provide the Board with maximum usefulness.

The benefits of a properly-drafted lease addendum do not end with addressing the troubled tenant issues. The usefulness of the lease addendum can extend to address another common problem with non-occupant owners: failure to pay assessments. All too often, non-occupant owners fail to pay their assessments, claiming that it was their belief that the tenant was supposed to pay them. While this excuse does not absolve the Owner from the obligation to pay all assessments, the lease addendum can be used to resolve this recurring problem. Language can be included in the lease addendum requiring a tenant to pay the Association the monthly rental payment to make up the shortfall in the assessment not paid by the owner of that unit, should the Owner become delinquent, after proper notice has been sent to all parties.

A properly-drafted lease addendum can serve a community association well when dealing with a number of issues, including problem tenants and non-occupant owners. If there is no authorization for the Board to adopt a lease addendum, amending the association Declaration or Bylaws to allow for such a requirement is something the Board may wish to consider.

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Best Practices

Is Your Association Adequately Insured?

ASSOCIATIONS MUST MAINTAIN ADEQUATE INSURANCE COVERAGE TO COVER DAMAGES CAUSED BY NATURAL DISASTERS--OR LEAVE THEMSELVES AT RISK TO COSTLY HOMEOWNER CLAIMS IF THEY DO NOT.

Serving as a reality check for community associations, recent natural devastations such as Hurricane Katrina highlight the critical need for associations to be properly insured for all potential losses. The damages to property from Hurricane Katrina alone are expected to result in \$40 to \$55 billion in private insurance payments. However, the floods, fires, tornadoes, and hurricanes that have devastated many communities in the south could happen almost anywhere.

Associations are required to possess adequate insurance coverage to protect themselves against natural disasters and other calamities. Protecting property against losses due to a flood, for example, requires an association to purchase flood insurance through the National Flood Insurance Program. The Program was created by Congress in 1968 to help control the growing cost of federal disaster relief. The NFIP offers federal flood insurance in communities that adopt and enforce effective flood plan management ordinances to reduce potential flood losses. Information about the National Flood Insurance Program, and protections against other natural disasters, can be obtained by visiting the FEMA website at www.fema.gov.

Rising Costs

The continuing increase in costs and materials needs to be carefully considered by all



community associations in making sure that their insurance policies are current. The cost of holding a policy that allows for rebuilding with full replacement cost is excessive, and most of the time associations do not maintain their policies to cover such increases in costs. Thus, a concern for all associations should be finding whether their policies are sufficient to fully replace a damaged structure, based upon today's values.

The responsibility for maintaining insurance coverage, including the types of coverage required by law or the Association documents, rests with the Board of Directors. Thus, associations should routinely speak with their insurance agent(s) to ensure that the Association is carrying proper coverage. Failure to maintain all necessary insurance in the proper amounts subjects the association, and the Board members, to claims by the owners. With few exceptions, community association directors and officers (D&O) liability policies do not cover claims for failure to purchase adequate insurance. Accordingly, the D&O carrier will not make-up any shortfall in coverage.

In summary, natural disasters are an unfortunate reality that community associations must endure. Thus, associations must be certain that their insurance policies will cover damages caused by such events. The association that does not do this risks leaving itself at risk to costly homeowner claims. Feel free to contact our offices if you have additional questions regarding this important issue.

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Lerch, Early & Brewer Community Association Group News and Notes

THE LATEST NEWS AND INFORMATION FROM OUR GROUP.



The firm announced recently that Joseph Braun, a senior at Northwest High School (Germantown), was the 2006 recipient of their Annual Scholarship Award. The scholarship has been awarded for the past six years to the Northwest football player with the highest cumulative grade point average, and who has been a member of the football program throughout all four years of the student's high school career.

Jeff VanGrack and **Paul Alpuche**, Chair of the firm's **Business and Taxation** Group coordinated the award with the school. Both VanGrack and Alpuche serve as volunteer coaches for the Northwest football team.

"We're very proud with how hard Joe worked during his four years at Northwest." VanGrack said. "The award is an affirmation of the work ethic that Joe has exhibited both on and off of the field."

The award was presented to Braun, who will be attending the University of Miami (Fl.) next year, at a school assembly on May 18.

The scholarship is part of Lerch, Early, and Brewer's association with the "Partners in Business and Education" program, which is sponsored jointly by the Montgomery County Chamber of Commerce and Montgomery County Public Schools.

On Thursday, April 27, **Jeff VanGrack** and **Jason Fisher** co-presented a seminar for association board members and managers entitled "Covenant and Rule Enforcement and Maryland legislative Update." The seminar, which was held in our Bethesda office, discussed topics including how and when to enforce covenants, enforcement tools, and an update on laws and regulations affecting community associations that came out of the most recent Maryland Legislative Session. Additional seminars on other pertinent topics are planned for the later in the year.

Jeff VanGrack and **Jeremy Tucker** recently authored an article for the journal "Quorum", the publication of the Washington Chapter of the Community Associations Institute. The article, entitled "Conflicting Interests: What Board Members Should Know" addresses the importance of the duty of loyalty that board members owe to their association. The article can also be found in this issue of the Update.

Jason Fisher was a panelist at the City of Rockville's "Neighborhood Network" discussion on April 8. The panel discussed, among other issues, Common Ownership, Controlling Documents, Maryland Acts: Title 11, Title 11B, Title 5-6a, Condominium Owner and Homeowner Responsibilities and Amending Governing Documents.

Jeff VanGrack has been appointed as Chair of the Planning Committee for the 2007 Law Seminar for the College of Community Association Lawyers (CCAL.) The Law Seminar is an annual event conducted by the Community Associations Institute that provides educational workshops and seminars for over 400 attorneys in the Community Associations field.

This past February, **Jeff VanGrack** spoke at the annual Washington Metropolitan Chapter of the Community Associations Institute Conference and Expo. Mr. VanGrack co-presented a topic entitled "How to Avoid Burnout: Stress and Time Management Techniques." The Conference and Expo is the largest Community Association industry event in the Washington, D.C. area.

We Would Like To Hear From You

We publish this newsletter as a service to our clients as a means to make them aware of certain aspects of the law. As always, we would like to hear feedback from our readers regarding the content of the newsletter. If there are items or topics you would like to see covered in future issues, or you have a suggestion concerning the newsletter itself, you may send them to Ben Harris at BJHarris@lercheearly.com, or via phone at 301-961-6096.

Additionally, a number of the Firm's other departments periodically issue highly informative newsletters on a variety of other subjects, including Employment and Labor, Commercial Lending, and Real Estate. If you would like one or more of these newsletters, you may access them through our website, www.lercheearly.com. To be added to the mailing list of any of the above-mentioned practice groups, simply send an email to Mr. Harris at BJHarris@lercheearly.com.

SUITE 460 | 3 BETHESDA METRO CENTER | BETHESDA MD 20814-5367
TEL: 301.986.1300 | www.lercheearly.com
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