TEN SELF-DESTRUCTIVE HABITS OF HOMEOWNERS' ASSOCIATIONS

Residential communities governed by a declaration of covenants and assessments can be great, particularly in rural areas where local governments cannot supply recreational amenities, neighborhood road care or even central water and sewer services. These communities, known generally as "common interest associations," are also inherently coercive.

Governing documents, which allow neighbors to improve the quality of their community, do so by giving a board of directors the power to levy monetary assessments on each owner and to administer a common fund of money that sometimes can more than a million dollars. Because this system of private taxation is subject to abuse, the Virginia legislature requires each common interest association to obey a complex set of laws that are frequently misunderstood by volunteer directors and association officers. Moreover, directors are often chosen by a small percentage of property owners who vote in annual elections, so it is easy to understand why associations sometimes become undemocratic.

Running a common interest association can be a tough job. It requires not only an understanding of the law that governs everything a board does, but it also demands a collaborative approach that many association officers fail to appreciate. Over the past 60 years, our law firm has organized dozens of common interest associations. Unfortunately, we have also been called upon to restore associations that have failed and to resolve disputes that have pushed homeowners' associations to the brink.

We have observed common patterns of failure. Here is a list of the most common problems.

1. *Bullying.* Many HOA leaders have backgrounds in business, government or the military, where they have succeeded with a rigid and muscular management style. Particularly if they view community association work as a commitment that should be handled as quickly as possible, leaders of this type often act in ways that either ignore legal requirements or at least seem authoritarian to other homeowners. Bullying (or perceived bullying) is one of the most common bad

habits of common interest associations. It is also one of the easiest to fix. Community leaders should remember that they work on behalf of all residents and that they succeed by adopting transparent "neighborhood friendly" policies. When in doubt, remember that HOA leaders most fundamentally are good neighbors.

2. *Secrecy.* Acting in secret or limiting management decisions to a small group might seem like efficient management, but it is against the law. The Virginia Property Owners' Association Act requires that all meetings of the board of directors and all committees of the board be advertised in advance and open to all association members. HOA leaders are specifically prohibited from using "work sessions or other informal gatherings" to "circumvent open meeting requirements" of the POA Act. The law also requires the board to keep minutes of all board and committee meetings and to make those minutes available to association members. There are narrow exceptions to these rules that must be followed in specific ways that are frequently misunderstood or ignored by association leaders. If your group uses unreported or unadvertised work sessions to accomplish or to plan association business, they are probably violating Virginia law.

3. *Cliquishness.* Older associations frequently fall into the unhealthy habit of perennially selecting leadership from the same small group of people. Some groups tightly control the board nomination process so that only existing directors decide who may stand for election to the board. We have even encountered one association that rotates board positions among a group of five named persons with no opportunity for association members to nominate or to elect other candidates. This type of cliquishness not only kills associations, but it usually is against the law. Leaders of successful associations open up responsibilities to as many people as possible and stay on the lookout for fresh leadership.

4. *Not Reading Association Documents.* Common interest associations only exist by virtue of a recorded document called a "declaration." It is the equivalent of a deed and it is no less important. Typically, a declaration will designate an association as the entity responsible for administering restrictive covenants and operating the association through the assessment process. The association is usually a nonstock corporation governed by two corporate documents, the most important of which is known as the corporation's "bylaws." All of these documents must be obeyed and, by design, they are usually difficult to amend. Many association leaders fail to appreciate the importance of understanding and following all association documents.

5. *Not Understanding State Law.* An association's documents provide the most important requirements for HOA governance, but they are not the only rules

that apply. Every property owners' association must also comply with a comprehensive state law that supplements the declaration and sometimes overrides it, particularly if the declaration lacks clarity. Similarly, Virginia's non-stock corporation act clarifies and often supplements corporate articles and bylaws. Many association leaders are not even familiar with state corporation laws and therefore ignore legal requirements related to corporate governance. Finally, many community associations fail to recognize that they are also subject to regulation by a Virginia administrative agency. Complying with all of these laws can be a challenge.

6. *Ignoring Capital Reserve Requirements*. Virginia's common interest laws require the association's board of directors to study the capital needs of the association at least every five years and to establish what is known as a "reserve fund" sufficient to "repair, replace and restore" items for which the association is responsible. Often, these items are common elements such as roads, septic systems, swimming pools, clubhouses or docks, but capital items can also include such things as exterior portions of connected residences. After the reserve study is prepared, the board must review its requirements yearly and confirm that reserved funds are sufficient to cover anticipated needs. Reserve funds are restricted and generally may not be used for purposes other than capital components. Important transparency rules also apply to this function and the board must keep association members informed of budgeting and capital reserves. Frequently, association leaders either ignore this requirement or fail to perform all steps required under state law.

7. *Ignoring Corporate and Fiduciary Responsibilities.* Association directors are required to perform their responsibilities according to a so-called "good faith business judgment rule," guided by the best interests of the community association. Directors also owe the corporation something known as a fiduciary responsibility that requires them to exercise independence and loyalty to corporate interests. By statue, associations must purchase and maintain a fidelity bond or employee dishonesty insurance in a statutorily mandated amount. These important requirements are frequently misunderstood by association boards and sometimes are not followed at all.

8. *Poor Accounting and Budgeting Practices*. Annual budgeting must be done in accordance with state law. Members must be provided with copies or summaries of proposed budgets prior to the commencement of the upcoming fiscal year and some governing documents even require budget approval by the membership. Often boards fail to follow the appropriate process. Closely related to this problem is poor administration of budgets and financial affairs in general. For example, many associations improperly spend restricted funds on general budget items. Other groups fail to recognize that spending restrictions even exist. Often, volunteer treasurers do not maintain clearly understood books. A

professional bookkeeper can help with the accounting, but that person should still be supervised by the board and not allowed to make independent spending decisions.

9. *Lack of Engagement with Members.* Some community association leaders try to avoid the involvement of their members. They sometimes do not want to bother with giving all required notices or keeping the records required by law. Additionally, very few associations obey a 2001 law requiring the association to establish a "reasonable, effective and free" method for members to communicate with each other and with the board of directors about any matter that relates to the association. Encouraging members to participate in association affairs is not only a good management practice, it is legally required.

10. *Failure to Seek Legal Advice.* Many HOA board members have a fear of lawyers. Perhaps it stems from a natural impulse to save association money but this approach is short-sighted. Fixing legal problems invariably is more expensive than satisfying legal requirements in the first place. The key is consulting a qualified attorney before a board takes significant action. Just as important are an annual review of the association's legal activities and an update regarding new laws that affect the common interest community.

Most of the pitfalls of running a community association can be avoided by using common sense, staying neighborly, and inviting a yearly legal review of association governance. Remember that community leaders are most importantly good neighbors entrusted with the serious responsibility of managing other peoples' property.

Dunton, Simmons & Dunton is the area's largest and oldest law firm. This article reflects our experience with dozens of local community associations but it should not be regarded as legal advice, which is always specific to unique facts.

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