

CONDOMINIUM GOVERNANCE — AN EXAMINATION OF SOME ISSUES

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FOREWORD

In response to Senate Concurrent Resolution No. 100, S.D. 1, H.D. 1, adopted during the 1988 legislative session, the Legislative Reference Bureau, with the assistance of the Department of Commerce and Consumer Affairs' Condominium Specialist, has conducted a study of problems relating to condominium governance. This study focuses on the issues of informed boards and owners, access to information and decision-making concerning condominium management and operations, and financial issues relating to condominium management and operations.

The Bureau extends its sincere appreciation to the many individuals whose cooperation in providing information, assistance, and guidance in the preparation of this study was invaluable. Special acknowledgement is made to Mr. John Morris, the condominium specialist, who participated in this study.

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Chapter 1

INTRODUCTION

Objective of the Study

In recent years, the number of bills relating to condominiums introduced at each session of the legislature have increased steadily. During the 1988 regular session of the legislature over 109 bills relating to condominiums were introduced.¹ Concern that the volume of these bills suggested the existence of a multitude of problems relating to condominiums and the manner in which they are governed prompted Senate Concurrent Resolution No. 100, S.D. 1, H.D. 1 (see Appendix A) which was adopted by both the Senate and the House of Representatives. The resolution requested the Legislative Reference Bureau (Bureau) to conduct an interim study of various problems concerning the governance of condominiums and, if appropriate, to propose feasible means and methods of dealing more effectively with such issues than is being done at present.

In particular, S.C.R. No. 100, S.D. 1, H.D. 1, requested the Bureau to address the following issues:

- (1) Are there reasonable controls on the use and treatment of condominium association funds?
- (2) Are current fiscal audits of association funds adequate?
- (3) Do owners receive adequate information regarding use of their maintenance fees?
- (4) Is the process for selection of association boards of directors fair and reasonable?

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- (5) Are there adequate checks and restraints to prevent the abuse of power by board members, managing agents, or managers?
- (6) Are there adequate avenues of information to boards and owners concerning condominium laws and regulations?
- (7) What is the extent of grievance problems experienced by condominiums with reference to items one through five above?

Additionally, the Bureau was to consider other comments and concerns provided by interested parties. The Resolution also directed the condominium specialist to be employed by the Department of Commerce and Consumer Affairs pursuant to Senate Bill No. 2501, S.D. 2, H.D. 2 (see Appendix B) to be a full participant in the study and requested the Real Estate Commission to cooperate fully with the Bureau in making records and other pertinent information available.

Methodology of the Study

Mr. John Morris was selected as the condominium specialist by Robert Alm, Director of the Department of Commerce and Consumer Affairs, and began work on July 1, 1988. Bureau staff had several initial meetings with Mr. Morris to formulate an approach to the study and to determine various tasks to be accomplished.² It was agreed that the Bureau would undertake the majority of the report drafting, with the condominium specialist providing general input and drafting several subsections of the report detailing specific examples of problems or concerns relative to the issues to be addressed. These subsections are identified and authorship is acknowledged where appropriate.

INTRODUCTION

Bureau staff and the condominium specialist shared data gathering activities. In addition to the many contacts made by the condominium specialist,³ information was obtained primarily through meetings and interviews with individuals representing from the following categories or associations: managing agents, general managers, association board members, certified public accountants, insurance agents, the Hawaii Independent Condominium and Cooperative Owners, the Hawaii Council of Association of Apartment Owners, and the American Arbitration Association. Bureau staff and the condominium specialist also attended a number of Condominium Property Regime Blue Ribbon Advisory Panel meetings as observers.⁴ In addition, information was obtained from the American Institute of Certified Public Accountants and the Community Associations Institute. Also, Bureau staff reviewed chapter 514A of the Hawaii Revised Statutes, condominium laws and rules in a number of other states, and prior studies of condominium related problems and issues in Hawaii.

Scope of the Report

S.C.R. No. 100, S.D. 1, H.D. 1, provided for a limited data gathering period.⁵ Bureau staff and the condominium specialist agree that the range of data produced is insufficient to allow conclusions as to some of the issues posed. Primarily, those issues are whether the process for selection of association boards of directors is fair and reasonable and what the extent is of grievance problems experienced by condominiums with respect to the other issues specified in the resolution. Because it is inherently dangerous to base conclusions on too narrow a range or sample of data, these issues are not addressed in this study. It may be noted, however, that the condominium specialist has expressed concern that, in some instances at least, voting and election procedures appear to create a perception of unfairness regardless of whether the unfairness actually exists. It is the Bureau's understanding that the condominium specialist will continue to monitor these as well as other issues and, if appropriate, may address them in a later report to the Legislature.

The Bureau has attempted to explore the remaining issues as fully as possible given the time constraints of the study. Nevertheless, some of these are complex and multi-faceted issues that, under ideal circumstances, would require additional time and study. Further, many of the concerns raised herein resist easy or simple solutions, as is evident from the fact that many of the same issues have been studied and discussed for a number of years with little or no resolution.⁶ Accordingly, the reader is cautioned that the discussions and recommendations that follow are not, nor do they claim to be, thoroughly comprehensive.

Organization of the Report

This report consists of the following:

Chapter 1 presents introductory material.

Chapter 2 discusses the issues of informed boards and owners and access to information and decision-making concerning condominium management and operations.

Chapter 3 discusses financial issues relating to condominium management and operations, including audits and other financial controls.

Chapter 4 contains findings and recommendations and is followed by footnotes and various appendices.

Chapter 2

LACK OF INFORMATION

INTRODUCTION

This chapter deals with three interrelated issues which Senate Concurrent Resolution No. 100, S.D. 1, H.D. 1, specifically requested the Bureau to address. These are:

- (1) Whether there are "adequate avenues of information to boards and owners concerning condominium laws and regulations?"
- (2) Whether "owners receive adequate information regarding use of their maintenance fees?" and
- (3) Whether there are "adequate checks and restraints to prevent the abuse of power by board members, managing agents, or managers?"

Access to information is the common theme that unites these three issues. The first two concern whether board members and owners have adequate access to information about laws and rules governing condominiums generally and about decisions affecting the management of their specific condominiums. The issue of informed boards and owners may be one of the most important of those reviewed by the Bureau during the course of this study because it permeates a number of other issues. The presence or absence of knowledge and information necessarily will affect all actions, decisions, and perspectives of boards and owners.

Moreover, access to information concerning the management of the condominium, including decisions made and actions taken by the board of

directors, is the primary means by which owners can monitor and, when necessary, restrain the power of the board and general manager or managing agent. The principle of open government has long been considered the most viable and reasonable method of protecting the public's interest and guarding against abuse of power.¹ Indeed, the proliferation of "freedom of information" and "sunshine" laws during the 1970's attests to the significance with which Congress and state legislatures view the public's right to know. Condominium associations often have been compared to municipalities or other mini-selfgoverning bodies.² The condominium association has powers and responsibilities similar to those of local governments: it collects assessments to pay for the expenses of operating the condominium and enforces the association's rules and regulations. The association manages the condominium through its elected board of directors, which essentially is the decision-making body for the association, administering the affairs of the association, setting policy, and assuring proper property maintenance. Given the analogy, it would seem undeniable that the decision-making process of an association's board of directors should be open to scrutiny and participation by association members as a means of deterring abuse of authority by boards and others involved in the management of condominiums.

AVENUES OF INFORMATION REGARDING LAWS AND RULES GOVERNING CONDOMINIUMS

To determine whether avenues of information concerning condominium laws and rules are adequate, the Bureau sought evidence of the extent to which board members and owners are aware, or unaware, of governing laws and rules affecting condominiums and condominium associations. For this evidence, the Bureau relied heavily upon the Department of Commerce and Consumer Affairs's condominium specialist who was directed by S.C.R No. 100, S.D. 1, H.D. 1 to be a full participant in this study.³ Accordingly, the following information is provided by Mr. John Morris, the recently appointed condominium specialist. The reader is cautioned that the statistics and conclusions contained herein regarding whether adequate information is available are only tentative at this point in time since Mr. Morris, who has

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been on the job only since July 1, 1988, has been in contact with but a few of the thousands of condominium owners in the State and has had the opportunity to investigate fully even fewer of the complaints he has received.

Comments of the Department of Commerce and Consumer Affairs Condominium Specialist⁴

With the foregoing caveat in mind, the condominium specialist makes the following preliminary, general conclusions: owners and board members are more familiar with their own condominium documents (declaration, bylaws, and house rules) than they are with chapter 514A, Hawaii Revised Statutes; and board members generally are more knowledgeable about the law and their condominium documents than are other owners. Assuming that owners with whom the condominium specialist has spoken are typical of most condominium owners, the condominium specialist provides the following observations and statistics:

- (1) Most owners are not aware of the particulars of the condominium property regime law, codified in chapter 514A of the Hawaii Revised Statutes, although many seem to assume some law relating to condominiums must exist. Approximately 75 per cent or more of owners who contacted the condominium specialist have never heard of chapter 514A. Also, a smaller but still significant percentage of board members, perhaps 10 to 20 per cent, have never heard of chapter 514A.
- (2) Of those persons who are aware the condominium property regime law exists, few know where or how to find it or know that the Real Estate Commission publishes annually an unofficial version that reflects recent amendments to the law. Moreover, even when informed that an inexpensive, unofficial copy of chapter 514A is available for \$1.25, few owners, perhaps 10 to 20 per cent,

expressed any interest in obtaining a copy. A slightly higher percentage of board members, 30 to 40 per cent, expressed interest in purchasing a copy.

- (3) Almost all owners and board members are aware of the existence of their own condominium's declaration, bylaws, and house rules. Fewer, however, are knowledgeable of the contents, ramifications, or priorities of those documents. Typically, owners appear to consult their documents only if a problem arises. Board members generally are more familiar with these documents because of their involvement in project operations.
- (4) Neither owners nor board members seem fully aware of the hierarchical relationship between the separate condominium documents. Many do not understand that there must be some basis in the declaration for the bylaws and some basis in the bylaws for the house rules. Similarly, some owners and board members do not understand that their documents may not conflict with chapter 514A or that their bylaws or house rules may not contradict their declaration.

Generally, most of the basic information owners and board members need regarding the operation of their condominium appears in their condominium documents and part V of chapter 514A, dealing with condominium management.⁵ Nevertheless, based on the number and type of inquiries received by the condominium specialist, it appears board members and owners lack sufficient information in the following areas: fiduciary duty; duty to act; delegation of power; relationships between officers and board members; due process and parliamentary procedure.

Neither chapter 514A nor most condominium documents adequately explain that board members owe a fiduciary duty to condominium owners to act with

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the highest degree of good faith and to place the interest of other owners above their own personal interest.⁶ Complaints were received that board members do not comply with the bylaws or house rules, apparently in the belief that they are entitled to special consideration. Complaints ranged from board members keeping animals contrary to the bylaws, to appropriating extra storage space, to making unauthorized improvements to their units. Questions regarding conflicts of interest by board members are common; however, owners frequently are confused about what constitutes a conflict of interest.

In a related area, owners contacting the condominium specialist frequently complain that their board has failed to take action in response to a problem or has taken an inordinate amount of time to consider and respond to a simple request. In some instances, owners unreasonably have expected instantaneous results, without considering that the board may need time to reach a decision. On the other hand, it appears some boards hope that their lack of or delay in response to controversial or difficult issues will discourage owners from pursuing the matter. For example, several owners complained that questions raised by them at board meetings remained unanswered by the board for months. One owner claimed to have spent a year waiting for the board to consider and approve a request to install a screen door to her unit. Another owner claims the board has taken months to address a problem of unauthorized parking. These types of complaints suggest that owners and boards are unaware of the board's responsibility to take action under certain circumstances to respond to owners or to enforce bylaws or house rules.

Contributing to the problem is a lack of understanding of the concept of delegation of powers. Some boards may not understand that when condominium documents transfer the ability to act from individual owners to a representative board, the responsibility to act also is transferred. Conversely, owners frequently seem unaware that they relinquish individual control when they move into a condominium.

Owners and board members also misunderstand the delegation of power to the managing agent.⁷ For example, some owners are perturbed that their treasurer does not have complete details of association finances at his or her fingertips but, instead, relies heavily on a managing agent. Several owners and board members have questioned whether a secretary may delegate responsibility for physically recording and typing the board minutes to the managing agent. Others have questioned whether such delegation relieves the secretary of the board from responsibility for the accuracy of the minutes. One association secretary reportedly was advised that her position was merely "honorary," with no real responsibility.

Frequently, owners and board members are confused about the relative powers and duties of board directors and officers. Some owners and board directors complain that the president has too much control over operational decisions. Some board members assume that because the board as a group directs the president, each board member can control the president. Accordingly, some members complain when the president ignores their individual wishes. Other board members, usually "dissidents," claim that a presidential clique has excluded them from meetings or committees or not even notified them of meetings.

Many owners and board members also seem to lack information about parliamentary procedure. Parliamentary procedure manuals are often complex and lengthy because they attempt to address every conceivable situation. Their length and complexity discourage reading by the average owner. Moreover, they often lack a concise explanation of situations that most frequently arise at a typical condominium association or board meeting. In fact, the manuals do not always seem appropriate for condominium disputes.⁸

Finally, it should be noted that many owners have unreasonable expectations in assuming they are entitled to the same peace and quiet and sovereignty over their surroundings as if they were living in a detached, single-family home.

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Conclusion

Based upon the information provided by the condominium specialist, it appears a number of board members and owners are uninformed of or are unfamiliar with condominium laws and regulations. Moreover, even among those aware of existing laws and regulations governing condominiums, many apparently do not fully apprehend the ramifications of the various rights, duties, and responsibilities of condominium owners and board members.

ACCESS TO INFORMATION RELATING TO CONDOMINIUM MANAGEMENT

Various sections of chapter 514A require that certain documents be made available to owners upon request. These documents include:

- (1) An accurate and current list of all apartment owners to be made available as provided in the declaration, bylaws, and house rules or for the purpose of soliciting votes or proxies or providing information to other owners with respect to association matters;⁹
- (2) Minutes of meetings of the board of directors and association of apartment owners and the association's financial statements;¹⁰
- (3) An accurate copy of the declaration, bylaws, house rules if any, master lease if any, sample original conveyance document, and all public reports and amendments thereto;¹¹
- (4) Detailed, accurate records of all receipts and expenditures affecting common elements, which specify and itemize the maintenance and repair expenses of common elements and any other expenses incurred, and

monthly statements indicating the total current delinquent dollar amount of any unpaid assessments for common expenses;¹²

- (5) A written summary, in layman's terms, of the association's insurance policy which includes the type of policy, a description of the coverage and the limits thereof, amount of annual premium, and renewal dates.¹³

In addition to these provisions, section 514A-83.1 mandates that all meetings of the board of directors, other than executive sessions, be open to all members of the association and allows members present to participate in the discussions unless a majority of the quorum of the board votes otherwise.

Given these provisions, it would seem unquestionable that chapter 514A intends a certain amount of scrutiny into, and participation by association members in, the management process. Despite this intention, it appears that the lack of access to information concerning condominium operations has led to, or at least played a part in, a number of problems being reported to the condominium specialist. Again, the condominium specialist has provided evidence of reported problems in this area, with the same caveat as noted earlier.

Observations by the Department of Commerce and Consumer Affairs's Condominium Specialist¹⁴

Many owners believe they should be entitled to a list of owners but most are unaware of their specific statutory right to such a list. Although a few instances have been reported where an owner has been denied an owners list, the availability of this document has produced relatively little controversy. The few instances reported include the following:

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- (1) One managing agent initially denied an owners list to an owner on the basis the information was considered private. When advised of the law, the managing agent readily complied.
- (2) An owner in a self-managed project on Maui also reportedly was denied a list, but this has not yet been verified.
- (3) One managing agent reportedly denied a list to a board member trying to recruit potential board members. The managing agent incorrectly informed the board member that the list was available only for the purpose of soliciting proxies.

The availability of board meeting minutes and financial statements also has not generated a great deal of controversy. Some owners have complained that the board or managing agent delayed in making the minutes available, but most owners eventually were able to review the minutes.

More frequent complaints concern the information contained, or not contained, in the minutes. Although in some cases the minutes provide a comprehensive summary of the meeting, in other cases the minutes provide only a brief, skeletal digest of the meeting. At least two reasons may exist for the contrast in drafting style. First, Roberts Rules of Order¹⁵ and other parliamentary handbooks require that minutes contain what is "done," not what is "said." Frequently, condominium board meetings lack structure and formality, with much being said, but little being done. As a result, minutes drafted according to Roberts can be very uninformative and may fail to give a complete, verbal picture of condominium operations and current issues facing the board. Several complainants have suggested that Roberts' drafting style has been used as a basis for "sanitizing" the minutes by removing discussion of condominium problems and criticisms of the board. Second, evidently some attorneys have advised boards to protect themselves against possible damaging

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statements or admissions that could end up being used against them in subsequent litigation by preparing "bare bones" minutes that omit any summary of discussions. A marked contrast exists between minutes of board meetings taken before and after such advice.

Another criticism reported concerning content of the minutes relates to omissions in the minutes of the fact that an owner attended a board meeting to raise a specific problem, complaint, or criticism. These omissions usually are based on the rationale that the problem or complaint was not resolved formally by way of a motion. Nevertheless, such omissions from board minutes frustrate owners and make them suspect ulterior motives on the part of board and managers. Moreover, one owner pointed out the importance of minutes as an information source for nonresident-owners. He suggested that, given the large numbers of such owners in the State, more comprehensive minutes should be required.

Several complaints also have been made that votes of board members are not being recorded in the board's minutes as required by section 514A-83.4. These complaints have not yet been verified.

A related issue with respect to the adequacy of the contents of the minutes concerns when a resident manager prepares a separate report in preparation for a board meeting. Such a report likely would contain relevant information about condominium operations and, if presented at the meeting, would seem to be incorporated by reference into the minutes. In at least one instance, however, an owner at a particular condominium was denied access to the manager's report, although the owner was given a newsletter, financial statement, and copies of the minutes free of charge.

There appears to be little complaint concerning the availability of association financial statements. As discussed below, however, supporting documentation for the financial statements is not always as readily available. Indeed, this appears to be the most controversial issue relating to availability of information. By its terms, the statute would appear to give broad access

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to this information.¹⁶ Nevertheless, owners have reported delays, ranging from days to months, in receiving this information and, in some cases, complete denial of this information. For example, a group of owners at a self-managed project on Maui reportedly are required to make appointments to review financial records and sometimes must wait for two or three days to see even current information. Also, an owner at a condominium on Oahu reports that after seven months she has still received no response to her request for records relating to delinquencies dating from 4-1/2 years ago. Apparently, the owner has received numerous promises and even obtained board approval for her request. Admittedly, the delay may result in part from the records being in storage and difficult to retrieve. Nevertheless, delays in providing financial information seem to cause as much frustration for owners as does outright denial of information.

A number of boards tend to treat inquiries and requests for information as if intended solely for the personal benefit of the requesting party and not in the general interest of all owners. They either are unaware or forget that chapter 514A is essentially self-enforcing, with the owners themselves having primary responsibility for ensuring their board complies with their governing documents and with state law. Therefore, many boards generally give information requests a low priority. This attitude, while common, seems contrary to the underlying intent of chapter 514A.

The difficulty of obtaining supporting financial documents also has arisen with respect to information concerning delinquencies. Section 514A-85 indicates owners are entitled to examine "monthly statements indicating the total current delinquent dollar amount of any unpaid assessments for common expenses."¹⁷ The first difficulty is with differing interpretations of exactly what is meant by the statute. Does it mean only the total dollar amount of all delinquencies, or does it mean the current total dollar amount that any one unit has been assessed for delinquencies? The second difficulty lies in whether owners can obtain supporting documentation on delinquencies, specifically, names and addresses of delinquent owners. For example, some boards will provide owners with only a list of the number of units delinquent,

taking the position that to reveal more would invade the privacy of the delinquent owners and subject the board to liability if delinquency records are incorrect. Other boards have no objection to releasing the names and addresses of delinquent owners.

Except in a few instances of small self-managed condominiums, owners have reported little difficulty in obtaining project documents (e.g., declarations, bylaws, house rules). Some owners, however, have complained about the cost of obtaining copies of the documents. The condominium specialist has received no complaints concerning the rights of owners to receive a layperson's summary of their insurance policy. Either owners are not aware of their right to such a summary or the summary is being provided.

Open board meetings should allow owners to obtain a great deal of information about the operations of their condominium, yet there still are a number of problems that arise. One of these concern owners' expectations about their right to participate at meetings. Owners who attend board meetings usually go for a specific purpose, wanting, and expecting, to participate in board discussions. Unfortunately, some owners fail to realize that the primary purpose of board meetings is to allow the board to complete its program agenda. Questions, comments, and challenges to the board can cause considerable disruption and delays, yet owners resent attempts to curtail their privilege of addressing the board. Recent changes in the law allow owners to address the board unless a majority of a quorum of the board votes otherwise.¹⁸ It should be noted that this change does not necessarily guarantee the owners' right to address the board.

Furthermore, some boards attempt to structure or confine an owner's participation. For example, one board voted at the beginning of its meeting *not to permit owner participation during the meeting*, but allowed a 30-minute question and answer session prior to the beginning of the meeting. In actual practice, however, the board also allowed questions from the floor. Another board routinely requests that written questions be submitted prior to the

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meeting to help focus owners questions and allow the board to prepare an adequate response. On the other hand, another board has a liberal question and comment policy during its meetings, which sometimes results in overly long meetings.

Another problem with board meetings relates to the meeting location. A common owner complaint regarding location is the lack of space and extra seating for owners who attend. Since many condominium projects lack an adequate meeting area, this problem cannot easily be solved legislatively. Often the most convenient but also most cramped meeting room is at the project itself. On the other hand, arranging for larger meeting space off-site has raised complaints that boards are trying to discourage owner attendance.

Lack of notice of board meetings is another problem area. Owners have a right to attend board meetings but no statutory right to notice of the meeting.¹⁹ There have been complaints of late, inadequate, or nonexistent notice. Even some board members have complained of lack of notice. For example, one board member alleges he was not notified of a board meeting to consider applicants for the position of resident manager. He claims that an unofficial personnel committee was set up without full board authorization and without any record in the board minutes. The same board member also claims to have been excluded from an executive session. Apparently the board member left a meeting temporarily to protest the way it was being conducted only to be locked out when he returned. Similarly, a board member of another association has alleged that he was not notified of board meetings whenever the board president determined that a quorum of directors favorable to the president would attend the meeting. As a result, the board member claimed that board communications were issued or policies adopted without his knowledge and without giving him the chance to state his opposition on the record. Somewhat related, one owner claimed that all or part of his board would meet prior to its official meeting to discuss and adopt policy. The official meetings that followed were mere formalities wherein the board rubber stamped the decisions made earlier.

Several owners also have complained that executive sessions of the board have been used as a way to avoid the general statutory requirement of open meetings. By law, executive sessions are limited to personnel matters and prospective or ongoing litigation.²⁰ Boards also must announce the purpose of executive sessions, presumably in sufficient detail for the owners to determine the purpose is valid.²¹ It is not clear that boards, whether intentionally or unintentionally, always fully comply with the law. Additional guidelines or rules may be necessary.

Telephone board meetings present another potential problem. Although chapter 514A does not forbid such meetings, they appear to evade the statutory requirement that owners be allowed to attend board meetings.²²

Finally, a problem particularly for resort condominium owners may be board meetings that are held infrequently (i.e., quarterly or semi-annually) or held out of state. In projects where none of the directors are permanent residents, some boards have agreed to meet at a convenient mainland location. Chapter 514A only addresses the location of annual meetings²³ and does not expressly forbid out-of-state board meetings. Resident owners wishing to attend these meetings might be forced to incur considerable expense in order to exercise their statutory right.

Conclusion

The language of chapter 514A clearly intends that owners have access to information and documents, including financial records, relating to the management of the condominium. For the most part then, it would appear the problems in this area are not with the statute itself but with the fact that some boards and/or managing agents apparently fail to comply, either unintentionally or intentionally, with the statute or with provisions of their governing documents.

EDUCATION

The observations of the condominium specialist suggest that a number of boards and some managing agents inadvertently fail to comply because they are unacquainted with laws and regulations governing condominiums. Likewise, many owners are unfamiliar with these laws and regulations and thus cannot perform their oversight function to ensure boards or managers do not exceed their authority. It also is apparent that some of the problems encountered by condominium occupants arise as a result of confusion and misunderstanding about the rights, duties, and responsibilities of the various parties involved. This is not surprising given that condominiums involve a unique form of property ownership vastly different from owning single-family property; the mechanisms by which condominiums are created involve sophisticated legal documents, and the means by which the associations are governed are complex and often confusing. Given the lack of information and the confusion concerning condominiums, there would seem to be a compelling need to acquaint board members, owners, and managers with their respective rights, obligations, and responsibilities and to familiarize themselves with Hawaii's condominium property regime law.²⁴

Other jurisdictions or organizations, realizing this need for education, have developed various informational materials for condominium owners and board members (see Appendix D). One of the more extensive educational programs undertaken by a state has been developed in Florida which has over 100,000 condominium units within the state. The Bureau of Condominiums, within the Division of Florida Land Sales, Condominiums and Mobile Homes, is responsible for the regulation of all condominiums and cooperatives in the State.²⁵ The Bureau of Condominiums has a staff of 41 and is organized into three sections, one of which is the Education Section.²⁶

The primary goal of the Education Section is to help the condominium and cooperative community understand its legal obligations.²⁷ The Section has prepared a Condominium Association Manual as a basic tool for those involved with condominiums. The manual is a compendium of the duties,

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responsibilities, and rights of unit owners and associations. It also summarizes declaratory statements and formal legal opinions issued by the Division. The manual and periodic updates are sent to every condominium association free of charge and are available to the public for a nominal fee.²⁸

The Education Section also prepares and distributes free of charge brochures on: unit owner rights and responsibilities, condominium living, an information guide of factors to consider when purchasing a condominium unit, insurance for the condominium unit, and other areas of interest (see Appendices E-H). The staff also conducts regional one-day seminars on various topics, such as election and voting procedures, budgeting and reserves, and recent amendments to the law, and respond to numerous written and telephone inquiries.²⁹ In addition, the Bureau of Condominiums has sponsored statewide conferences consisting of informational presentations and panel discussions concerning directors' responsibilities, insurance, association management, financial management, and federal and state income tax issues.³⁰

Obviously, a similar undertaking in Hawaii would require more staff and funding than currently allocated to the regulation of condominiums. Nevertheless, the Legislature should consider allocating additional resources to the Real Estate Commission (or the condominium specialist if the position is made permanent) for purposes of preparing educational material, in the form of a handbook, manual, brochures, video, seminar, or other educational tool, to provide a useful guide to boards and owners concerning their respective rights, duties, and responsibilities generally and Hawaii's condominium property regime law specifically. The Commission may find it helpful in this undertaking to convene an advisory group or task force of representatives from other agencies and groups involved in the condominium field to assist it in determining content, format, and the most feasible and effective means of distributing such information. Such a task force might include, although not necessarily be limited to, representatives of the following: the American Arbitration Association, the Community Association Institute, Hawaii Independent Condominium and Cooperative Owners, the Hawaii Council of

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Associations of Apartment Owners, condominium property managers, the Office of Consumer Protection, and the Hawaii State Bar Association.

RULEMAKING AUTHORITY

Apparently, another reason why a board or managing agent fails to comply (or why an owner may think a board or agent has failed to comply) with a particular provision of the statute or of a governing document may stem from a difference in interpretation, rather than lack of awareness. For example, the law may grant a right or impose a duty but lack specific guidance as to how the right should be exercised or the duty performed. As a result, the provision may be subject to various interpretations by owners, boards, their attorneys, or managing agents, thus providing a fertile ground for dispute. For example, section 514A-85 requires that records of all receipts and expenditures relating to maintenance and repair of the common elements be made available to owners upon request, but it neither specifies nor limits the number of past years for which the records must be made available. As a result, what really is required under this section has been subject to various interpretations. For example, in one instance a managing agent, on the advice of counsel, permitted an owner to review receipts only for the current year.³¹ Moreover, the ambiguity or uncertainty that can result from various interpretations may lend itself, in some instances, to arbitrariness or overreaching on the part of a board or property manager. Accordingly, some direction or guidance may be necessary in these instances to prevent intentional or unintentional abuses.

One option might be adoption of rules by the Real Estate Commission setting forth specific direction or guidelines for those statutory sections wherein interpretation problems arise. This would establish some certainty and uniformity, thus eliminating any ambiguity or arbitrariness in interpretation. It is uncertain, however, whether the Real Estate Commission presently has general rulemaking authority under part V of chapter 514A

(relating to condominium management), other than perhaps with respect to sections 514A-84, 514A-85, and 514A-95.³²

Consequently, if the Legislature determines that rulemaking on the part of the Commission would be useful in providing clarification and guidance, the Bureau suggests that a new section to part V be enacted that grants authority to the Commission to adopt, amend, or repeal whatever rules it deems necessary to effectuate fully the purpose of part V. It should be clear that such rulemaking authority includes the authority both to forbid acts or practices deemed by the commission to be detrimental to the accomplishment of the purpose of part V and to impose such requirements as will better enable the Commission to enforce part V and any rules adopted pursuant thereto.

Enforcement

Finally, where there is noncompliance by a board or manager with provisions of the statute or governing documents, owners should have some viable means of forcing compliance. Particularly where the law clearly provides a right of access to information to owners, an owner should have some practical, affordable means of enforcing that right. Unfortunately, it appears that in many instances owners realistically have no viable means to enforce compliance. Chapter 514A essentially is self-enforcing, meaning an owner's remedy is to file a legal action to compel compliance. In reality, however, the courts are inaccessible to many owners: litigation is expensive, and for some, the high cost constitutes a total bar to the judicial process.³³ In other cases, the nature of the dispute itself is insufficient to justify the expense. Furthermore, many cases take months, even years, to resolve; under such circumstances, an eventual victory for the owner may be an empty one.³⁴

In 1984, presumably in an attempt to settle internal disputes involving owners, associations, boards of directors, and managing agents in a quicker and less costly manner, the Legislature amended chapter 514A to provide for arbitration of certain types of disputes at the request of any party.³⁵

LACK OF INFORMATION

Judging from the statistics of the American Arbitration Association, however, many of the disputes involving condominiums apparently are not being arbitrated. Between 1984 and June 1988, only 45 condominium disputes have been arbitrated.³⁶ According to Keith Hunter, District Director of the American Arbitration Association in Hawaii, many more requests for arbitration have been filed, but were rejected for arbitration because they fall within one of the exceptions to arbitration enumerated in section 514A-121(b).³⁷

A substantial majority of these excepted disputes involved actions to collect assessments that are liens or are subject to foreclosure.³⁸ The problem with this particular exception is that frequently there is an underlying dispute that is appropriate for arbitration but, unfortunately, the owner (apparently often unaware of the consequences of this action) has withheld maintenance payments because of the underlying dispute. In response, the association then files a lien against the owner's property, foreclosing arbitration and forcing the dispute into the courts.³⁹ This naivete on the part of owners prevents many from being able to take advantage of the arbitration process. It has been suggested that a number of other disputes fail to make their way to arbitration because many parties (i.e., owners and associations) may be unaware of their option to arbitrate or because many attorneys, steeped in the advocacy tradition, generally tend to steer clients toward litigation.⁴⁰ It seems clear that if arbitration is to achieve the purpose intended by section 514A-121 of providing a relatively inexpensive and quick forum for dispute resolution, more members of the condominium community, particularly owners, need to be apprised of its existence, the circumstances under which it is available, and its advantages. This reiterates the need for widespread, comprehensive education of owners and board members.

In addition to taking steps to make arbitration a more effective forum, other measures may be necessary to help ensure compliance with chapter 514A. In recent years, such ideas as mandatory mediation or a condominium commission or board have been suggested.⁴¹ These alternatives are beyond the scope and time constraints of this study. The Bureau notes, however,

that the Florida Condominium Act, which provides for voluntary arbitration, also grants the Division of Florida Land Sales, Condominium and Mobile Homes broad powers to enforce all aspects of the condominium law and rules adopted pursuant thereto, including those relating to the operation and management of residential condominiums.⁴² These powers include, but are not limited to, the ability to make rules, conduct comprehensive investigations, issue subpoenas, institute enforcement proceedings in its own name or on behalf of others, issue cease and desist orders, and impose civil penalties.⁴³

Compliance with the Florida law is aggressively enforced by the Division through its Bureau of Condominiums. The Bureau's Enforcement Section is responsible for the investigation of complaints. The Bureau of Condominiums attempts to resolve complaints amicably to the satisfaction of all parties and has found that apparent violations often occur simply because the parties are unaware of the requirements of the law; once parties understand the law and its ramifications, many comply voluntarily.⁴⁴ Moreover, having one agency handling exclusively condominium investigations and enforcement of the condominium act has encouraged consistent application of the law between examiners, investigators, and educators and has provided those involved in the condominium community with one source for consistent advice and counsel concerning residential condominiums.⁴⁵

Although the Hawaii Real Estate Commission has jurisdictional responsibility over condominiums, it is unclear whether it has any real enforcement authority over most issues relating to condominium operations or management.⁴⁶ Moreover, even if it were clear that the Commission has authority to enforce compliance with part V of chapter 514A, the Commission lacks adequate staff and resources to do so. The creation of the position of condominium specialist is a small step toward providing at least some resource for the condominium community in Hawaii; however, the position is only temporary and also lacks any enforcement power or support staff.⁴⁷ The Legislature may want to consider creating an agency similar to Florida's Bureau of Condominiums (either as part of the Real Estate Commission or as a separate agency within the Department of Commerce and Consumer Affairs)

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with sufficient powers, staffing, and funding to operate in a like manner. If the Legislature decides the creation of a new agency is unwarranted, however, it, at the least, should consider making the condominium specialist position permanent, with more clearly defined duties and powers and with funding for support staff and equipment.

Chapter 3

FINANCIAL ISSUES

INTRODUCTION

Senate Concurrent Resolution No. 100, S.D. 1, H.D. 1, specifically requested the Bureau to address the *following financial issues in this study*:

- (1) Are there reasonable controls on the use and treatment of condominium association funds?¹
- (2) Are current fiscal audits of association funds adequate?
- (3) Do owners receive adequate information regarding use of their maintenance fees?

These issues are interrelated and overlapping. For example, audits and access to financial information are both a means of controlling or monitoring the way association funds are handled and spent. Accordingly, this chapter will discuss *financial audits and access to financial information* within the context of reasonable controls on the use and treatment of association funds.

EXISTENCE OF REASONABLE CONTROLS ON ASSOCIATION FUNDS

The question of whether there exist reasonable controls on association funds appears to encompass two distinct issues: (1) whether there are adequate safeguards to prevent condominium managers,² association employees, or board members from misappropriating association funds and (2) whether association funds are being expended and managed properly. Adequate financial controls should reduce the risk of loss resulting from dishonesty, mismanagement, or negligence.

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Several types of financial controls are possible. The degree to which they are imposed or observed, however, varies among associations. The financial controls discussed here concern: annual financial audits, internal accounting controls, access to financial records, and fidelity bonds.

AUDITS

The resolution specifically requested an inquiry into whether current fiscal audits of association funds are adequate. This inquiry has two facets: whether section 514A-96, Hawaii Revised Statutes, concerning audits of condominium associations' funds is sufficient and whether the audit process provides adequate protection.

Section 514A-96

As originally adopted,³ section 514A-96 provided for a yearly audit and no less than one unannounced audit of association funds by a certified public accountant. Both audits could be waived by a majority vote of all apartment owners.

This section was amended in 1986 to change the unannounced audit to an unannounced verification of the association's cash balance and to delete the word "certified" before the phrase "public accountant."⁴ According to testimony and committee reports, it appears these changes were made to achieve the original intent of section 514A-96, which was to provide for an unannounced cash verification and not a second audit, and to allow public accountants as well as certified public accountants to conduct audits.⁵ As noted above, the first issue is whether the current version of section 514A-96 provides adequate protection. The law provides that an audit and an unannounced cash verification must be conducted yearly, unless waived by a majority of all apartment owners. The possibility exists, then, that under present law both the audit and the cash verification could be waived by an association.

Accordingly, the question becomes to what extent are audits being performed or waived. A report to the 1988 Regular Session of the Legislature by the Real Estate Commission concerning fidelity bonds included a discussion of the audit requirement. The study found that, although a majority of associations with managing agents undergo an independent audit annually, many others waive the audit but have an outside accountant conduct an unannounced cash balance verification.⁶ Furthermore, with regard to self-managed associations, the study found that most handle their own accounting in-house and waive the requirement for both the annual audit and the unannounced cash balance verification by a public accountant.⁷

Similarly, interviews of board members and property managers by Bureau staff and the condominium specialist suggest that, although many associations require an annual audit, there are a considerable number that do not undergo an annual audit. The explanation commonly cited as to why associations may choose not to undergo an annual audit is the expense. The cost of an audit varies depending upon the size of the association, the amount of work involved in the audit, and the auditor⁸ performing the audit. The cost runs between an estimated \$600 and \$2,000 unless performed by one of the "big eight" accounting firms, in which case it could run considerably higher. Moreover, audits for larger associations can range between \$3,000 to \$6,000.⁹ In contrast, the cash balance verifications usually cost between \$100 to \$500, although in the case of one larger association, it was put at \$1,000. Some managers suggested a second reason why associations may waive the audit: associations that are satisfied with their managing agent's performance may be more likely to decide an audit is an unnecessary expense. This may be especially true of smaller associations that have fewer units (e.g., 6 or 10) over which to spread the audit cost.

Of those property managers interviewed, nearly all indicated they strongly recommend to their client associations that they have an audit done annually. A few managing agents associated with larger companies inferred that agents for smaller companies are less likely to encourage their client associations to undergo an annual audit in an attempt to save the association

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money.¹⁰ Based on the comments of managing agents, the majority evidently consider the audit as a safeguard mechanism for themselves and their companies, as well as for the board members and the association.

Furthermore, the agents interviewed reported that a majority of their client associations follow their advice in having an annual audit. For example, one property management company, which manages approximately 150 associations, estimated that all but about two associations (both of which are small: 6 units and 21 units) undergo the audit, while one-half or more also have the unannounced cash balance verification conducted. Another property management company, handling over 200 condominium associations, estimated that about 75 per cent of these clients undergo a financial audit. However, there was some indication that, out of these, at least a few associations have the audit only every couple of years as opposed to annually. Also, agents reported that about 50 per cent of these client associations have a cash balance verification performed, usually in addition to the audit. Only a few of these associations undergo the cash balance verification as a substitute for an audit.¹¹ The president of a smaller management company (handling 16 condominium associations ranging in size from 50 to 375 units) reports he will not accept a management contract with an association unless the latter undergoes an annual audit. In negotiations, he strongly advises the associations that the law requires both the audit and the unannounced cash balance verification.

Representatives (e.g., the board president and or the general manager) of three of the largest self-managed condominium associations on Oahu (with the number of units ranging from approximately 430 to 670) were interviewed, and all indicated their associations undergo an audit annually. These individuals also expressed the opinion, similar to that of managing agents noted previously, that an audit protects the board members and the general manager as well as the association. The frequency of the unannounced cash balance verification varied among these associations from every year to every several years. A few interviewees acknowledged that the cash balance verification does not give that much added protection to the association in

that it only verifies cash on hand at a particular time. Given its relatively small cost, however, most interviewees thought it worthwhile.

The condominium specialist received a number of calls that suggest audits may be conducted infrequently or waived altogether at smaller self-managed projects. For example, he reports that:

- (1) A board member of a 66-unit condominium on Maui stated that no audit had been made of association funds for the last 14 years. The condominium's accountant or bookkeeper had, in fact, recommended against the audit on the basis that it would cost as much as \$3,000.
- (2) A board member of a 90-unit self-managed condominium on the Big Island called to confirm her accountant's advice that a yearly audit was required by law unless waived by a majority of owners. Audits had been neither performed nor waived in the past.¹²
- (3) A board member of a 13-unit self-managed condominium, also on the Big Island, stated that his condominium had an informal, "unofficial" audit once a year. The board did receive, however, a monthly financial statement from the accountant. The board member stated he felt these "controls" were adequate given the size of his condominium.

Furthermore, the condominium specialist has discovered that several small condominium projects lack any formal organizational structure whatsoever, much less undergo an annual audit. Given the number of these projects of which the condominium specialist is aware, it is probable there are many more similarly situated condominium projects of which he is unaware. Accordingly, it would seem there are a number of smaller condominiums that are not

complying with section 514A-96 as well as with other statutory requirements relating to the management of condominiums.¹³

What an Audit Does

The second issue relative to audits is whether the current audit process provides adequate safeguards to protect association funds. To answer this question, it is necessary first to understand what an audit is and what it is not. Generally stated, a financial audit is an opinion on the fairness of the presentation of financial statements in accordance with generally accepted accounting principles (GAAP). Phrased differently, a standard audit opinion provides reasonable assurance that an entity's financial statements present fairly, in all material respects, its financial position, results of operations, and cash flows in conformity with GAAP.¹⁴ Contrary to what many believe, however, an audit opinion is not an endorsement or report on an entity's policy decisions, its use of resources, or the adequacy of its internal control structure.¹⁵

An audit should be conducted in accordance with generally accepted auditing standards (GAAS).¹⁶ According to GAAS, an auditor should examine the internal accounting controls of the entity subject to audit and assess the risk of material misstatement.¹⁷ An understanding of the entity's internal control structure should either heighten or mitigate the auditor's concern about the risk of material misstatements. Based upon the auditor's overall judgment about the level of risk of material misstatements, the auditor then designs the audit plan to obtain reasonable assurance about whether the financial statements are free of material misstatements.¹⁸ The audit includes examining, on a test basis, data underlying the financial statements.¹⁹

In testing the data, the auditor does not examine 100 per cent of the information supporting financial statements, nor would it be economical to do so.²⁰ The auditor exercises professional skill and judgment in conjunction with knowledge of the specific circumstances of the client to determine what, when, and how much to "test."²¹

In considering whether audits provide sufficient safeguards, the limits of an audit must be understood: normal audit test procedures will not detect all irregularities or frauds, especially if concealed through forgery or collusion.²² Furthermore, auditors are not trained to detect forgeries. Thus audits do not, and are not intended to, guarantee the accuracy of financial statements. They do, however, provide an economical and reasonable level of assurance that the financial statements are free of material misstatements.²³ Also, an association audit covers only financial transactions of the association; it is not an audit of the managing agent. Accordingly, an association audit would not necessarily detect the fact that a managing agent is engaging in unethical behavior (such as receiving kickbacks).

The American Institute of Certified Public Accountants (AICPA) recently circulated an exposure draft of a proposed Audit and Accounting Guide, for use with respect to common interest realty associations which include condominium associations.²⁴ The exposure draft was prepared in response to increasing requests from practitioners for guidance in auditing and accounting for condominium associations, homeowners' associations, and cooperative housing corporations. Major recommendations in the exposure draft that are particularly relevant to this discussion concern: the auditor's role in evaluating the adequacy of disclosures of anticipated major repairs and property replacements of common elements and reporting on the fund for future major repairs and replacements (i.e., the reserves); the appropriate method of accounting; and audit procedures specifically applicable to common interest realty associations. The exposure draft recommends the use of fund accounting, which commonly is used by not-for-profit organizations, on the basis that it more clearly presents information about an association's two primary activities, (i.e., current operations and long-term maintenance and repair of the common elements) and more clearly illustrates whether assessments have been used for other than their designated purposes. It is possible these recommendations could change between now and the time the final draft is completed sometime in 1989.²⁵ However, once the final guidelines are adopted, they will be the generally accepted accounting principles which auditors of condominium associations would be responsible for

following,²⁶ and presumably the auditors will make whatever adjustments necessary to conform to these principles.

Assuming the current recommendations are the ones adopted, at least one adjustment that may be necessary would entail changing the current method of accounting used by associations. Presently most, if not all, associations in Hawaii use the cash method of accounting for funds. The cash basis of accounting recognizes revenues when received rather than when earned and recognizes expenses when paid rather than when the obligations are incurred. Generally accepted accounting principles, however, contemplate the use of the accrual method of accounting, which provides a more accurate matching of revenue earned against expense incurred.²⁷ The accrual method recognizes revenues when earned and expenses when the obligation is incurred. Because the accrual method displays an association's financial condition more accurately, many consider it the better accounting method for most associations, especially larger ones where considerable sums of money must be handled and there are several sources of income and many categories of expense.²⁸

Despite the deviation from GAAP of current association accounting methods, an auditor can still give a clean opinion as to the fair presentation of an association's financial statements prepared on a cash basis of accounting, as long as that basis has been applied in a manner consistent with that of the preceding year.²⁹ However, the auditor must clearly disclose in the audit opinion that there is a deviation from generally accepted accounting principles (see Appendices I and J for examples of such audit opinions).

Another change in current practice that may be necessitated, again assuming the current recommendations are adopted, concerns the disclosure of anticipated major repairs and property replacements of common elements and the auditor's role in evaluating the adequacy of disclosures and reporting on the fund for future major repairs and replacements.³⁰ One of the primary responsibilities of an association is to maintain and preserve the common

property. Good management practices would require an assessment of the need for future major repairs and replacements and planning for funding the costs entailed. Associations may budget for these anticipated costs over extended time periods, collecting regular assessments from owners and depositing them into a reserve fund or may fund the costs through special assessments. Inadequate funding may be construed as a breach of a board's fiduciary duty, especially if association documents require an assessment of members for future major repairs and replacements, and also may affect adversely the ability of owners to sell or refinance their units.³¹ Interestingly, several states, including California,³² Florida,³³ and Oregon,³⁴ require the identification of the estimated remaining life of and repair or replacement costs of and the establishment of a reserve account to defray the repair or replacement costs of those common elements which the association is obligated to maintain.

Requirements in Other Jurisdictions

Bureau staff compared relevant portions of various state statutes with section 514A-96. Of note is California's law which specifies that an association's operating budget shall include an estimate of revenues and expenses on an accrual basis³⁵ and requires that a review³⁶ of associations' financial statements be prepared in accordance with generally accepted accounting principles by a California State Board of Accountancy licensee for any fiscal year in which the gross income of the association exceeds \$75,000.³⁷ Alabama³⁸ and Virginia³⁹ also require all association financial books and records to be kept in accordance with generally accepted accounting principles. Alaska's law requires that all association books and records be kept in accordance with "good accounting procedures" and be audited at least once a year by an auditor outside the organization.⁴⁰

Likewise, Florida's law requires that an association's accounting records be kept according to good accounting practices.⁴¹ Another provision requires the Division of Florida Land Sales, Condominium and Mobile Homes of the Department of Business Regulation to adopt uniform accounting principles,

policies, and standards to be used by all associations in the preparation and presentation of all condominium financial statements required by law. These principles, policies, and standards are to consider the size of the association and the total revenue collected by the association.⁴² The division also may adopt rules requiring financial statements to be compiled, reviewed, or audited, taking into account the above considerations; however such requirements do not apply to condominiums consisting of 50 or fewer units or to an association if a majority of the voting interest present at a duly called association meeting determines for a fiscal year to waive the requirement.⁴³

Conclusion

In view of the foregoing discussion, it appears a financial audit of association funds is an effective and affordable safeguard to the extent that it provides reasonable assurance that an association's financial statements are fairly presented. Granted, an audit cannot be relied on as a guaranty of a complete "clean bill of financial health." Nevertheless, a financial audit should reveal certain irregularities which will result in a material misstatement in the financial statements. Furthermore, it should be acknowledged that having an independent, impartial expert, who is knowledgeable of the entity's business and financial reporting requirements, examine the association's record and report to the members may be sufficient, in many cases, to deter any mishandling of funds and to ensure proper accounting procedures, thus enhancing confidence that the financial statements do not contain material misstatements.⁴⁴

As noted previously, however, not all associations undergo an annual audit. Interview data suggest that those associations with more formalized management, either through an established management company or self-managed with an experienced general manager and active board, are more likely to engage in an annual audit for the protection not only of the association but also of the board and the manager or managing agent. Those associations that do not undergo an audit apparently do not do so for a

number of reasons including, although are not limited to: cost of the audit, confidence in the managing agent, or ignorance of the requirement.

One means of ensuring all associations have the benefit of an audit is to eliminate the option provision from section 514A-96. Conceivably, the Legislature, either when it adopted or amended section 514A-96, already may have considered this course of action. It is acknowledged that to require an audit for all associations could create a financial hardship for some associations, especially for those with only a few units over which to spread the cost. Accordingly, another means of ensuring that a greater number of associations have an annual audit, would be to restrict the option not to have an audit only for those associations with less than a certain number of apartment units (e.g., 50 or 25) or, similar to California, with less than a certain amount of annual gross income. It should be recognized, however, that such an amendment will not necessarily address the problem of those associations that fail to undergo an audit due to ignorance of the requirement (although in actuality many of these may be associations with fewer than 50 units). This problem reinforces the argument that an educational undertaking is needed with respect to members of the condominium community.

INTERNAL FINANCIAL CONTROLS

As noted earlier, the auditor designs his audit plan based on an evaluation of internal accounting controls. There are a number of standard financial controls that are considered to guard against theft, mistake, or fraud. These include: restricting access to association funds; separating duties performed by accounting personnel -- for example, the person approving invoices should not be the one writing checks and the person recording receipts should not be the one making deposits; involving multiple parties whenever cash is handled; minimizing cash transactions; prohibiting co-mingling of association funds by a managing agent with those of other associations;⁴⁵ minimizing the handling of association funds by depositing

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checks directly to the association's account via a bank lock-box; and conducting an annual financial audit or review.⁴⁶

It is difficult, if not impossible, to determine and assess the internal financial controls under which the approximately 1,341 condominium projects⁴⁷ in the State operate. There is evidence, however, that at least some, if not a larger number, of associations and/or management companies do not use these internal accounting controls.⁴⁸ Indeed, this appears to be one reason why fidelity bonds are difficult to obtain.⁴⁹ One problem frequently noted was the failure to maintain separation of duties by accounting personnel. This problem may be predictable for small self-managed associations or smaller management companies that have few employees, but at least one person interviewed contended that the problem also exists within most of the larger management companies.

Of the other internal controls mentioned above, restricting access to association funds is the only one (other than audits which is discussed earlier in this chapter) for which sufficient information was obtained to permit a reasonable discussion.

Access to Association Funds

Conventional wisdom suggests that access to association funds may be restricted or controlled by requiring two signatures (one of which is that of an appropriate board officer) on all checks over a certain dollar amount or, in the alternative, keeping the operating account balance at a minimum, with the majority of funds in a reserve account, and requiring two signatures on any transfer of reserve funds.⁵⁰ It also has been suggested that an association retain sole control over its reserve funds. To determine what the prevailing practice, if any, is with respect to access to association funds, Bureau staff again consulted the Real Estate Commission's 1988 fidelity bond study, which included a discussion of the issue, and also interviewed a number of persons involved in the condominium field.

With regard to access to bank accounts, the 1988 study found the following:

1. Self-managed associations generally do not require two signatures (e.g., that of an association officer and the general manager or two officers) on association checks or fund transfers.⁵¹

2. Although in the case of a given management company the method of handling funds may vary from one client association to another, the common practice appeared to be to allow the company (i.e., usually an officer of the company) to have sole signature authority over the association's operating funds, with a second signature by a board officer required in only a minority of instances. With respect to transactions involving reserve accounts, a majority of associations required at least one board member's signature, and only a minority required dual signatures (i.e., an officer of the management company and a member of the board).⁵²

3. The report concluded that only a few associations retain sole signature authority over their bank accounts (reserve as well as operating accounts).⁵³

4. A majority of insurance companies interviewed as part of the fidelity bond study contended that most associations were not as conscientious about financial management as they should be and delegated too much responsibility to their managing agents. They also indicated that self-managed associations generally had inadequate financial controls.⁵⁴

The following impressions are based on responses received during interviews conducted by Bureau staff and the condominium specialist.⁵⁵ These impressions are separated into three categories: associations managed by larger property management companies; large self-managed associations; and smaller self-managed associations or associations managed by smaller management companies.

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The general tendency of the larger condominium management companies interviewed is to retain sole signature authority over a client association's operating and reserve accounts.⁵⁶ In a minority of instances, dual signatures (i.e., that of a company officer and a board officer) are required with respect to reserve accounts. A few associations retain sole control over their reserve accounts, and an even fewer number have sole control over both accounts.⁵⁷ For example, one large company (managing over 100 associations with approximately 18,000 total units) has sole signatory power over all client associations' operating and reserve accounts. Another company (managing over 150 associations) reported it has sole signatory power over nearly all of its client associations' operating accounts and over 80 per cent of their reserve accounts. Of the remaining 20 per cent, perhaps one-fourth of the associations retain sole control over their accounts, and the rest share signatory control with the company. Still another large company (managing over 200 associations) has sole signatory control over both types of accounts for over 90 per cent of its client associations. Of the remaining 10 per cent, some associations retain sole signature control, and in the other instances responsibility usually is shared.

One property manager handling 54 projects reported that he has sole signatory control over all accounts, except for 5 associations that have retained control over their reserve account. As part of his management contract with these associations, he requires the association to maintain a fidelity bond that covers board members handling the reserve funds. He reported considerable difficulty getting board members to accept responsibility for signing checks. A number of others interviewed echoed this drawback to having the board retain signatory control over, or even share responsibility for, their bank accounts. The most interesting comment in this regard came from an accountant who audits between 40 and 50 condominiums annually. In the case of approximately 90 per cent of these condominium associations, management companies have sole signatory control over both reserve and operating accounts. The accountant reports that yearly he has recommended to these associations that they require dual signatures be required on their reserve accounts and maintain only a minimum balance in their operating

accounts as a deterrent to fraud. His advice is consistently ignored, partly because of "laziness" on the part of board members who do not want to be responsible for signing checks and partly because managing agents discourage it because of the administrative difficulties it would create for them.

Representatives of two of the large management companies referred to earlier contended that, despite the company retaining sole signatory control over association funds, these funds are protected sufficiently by the companies' internal financial controls, which included requiring three company officers' signatures, in one case, and two company officers' signatures, in the other, on each and every association check written. Interestingly, one of the other large companies interviewed is considering adopting a policy of requiring dual signatures for all association checks or transfers over a certain dollar amount. The reasons behind this contemplated change are to: reduce the amount of funds under the company's direct control; increase client confidence in the company; and improve the insurability of association funds.⁵⁸

Some of the larger self-managed condominiums appear to have in place a number of internal controls over access to association funds. For example, generally checks over \$1,000 require two signatures, usually an officer of the board and the general manager, although in some instances signatures of two board members may suffice. Checks under \$1,000 usually may be signed by the general manager alone; however, the person issuing the check (usually an employee accountant) is never the same person authorized to sign the check (the general manager). Also, in at least one project, the treasurer is not allowed to sign checks because he or she is responsible for reviewing the general ledger each month. Thus, in this project, checks over \$1,000 must be signed by either the president or the secretary and by the general manager.

Without a comprehensive survey, it is impossible to state authoritatively any general approach on the part of smaller management companies and self-managed condominiums with respect to controls over access to funds.

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Moreover, basing impressions solely on the limited interviews conducted and on information obtained to date by the condominium specialist, it would appear that no one general approach exists. For example, one management company handling nine associations has sole control of all operating accounts, but requires dual signatures (an officer of the company and a board member) for all reserve accounts. Another company managing 10 projects shares control with the client associations on all accounts--both operating and reserve. In this case, an officer of the company and either the president, secretary, or treasurer must sign on behalf of the association. A company managing 16 associations has a policy of maintaining a minimum balance to cover monthly expenses in the operating account and depositing anything above this amount in the association's reserve account. An officer of the company and a board officer must sign on any checks or transfers from the reserve account. Finally, a management company on Kauai, which handles 14 associations in which almost all owners are nonresidents, indicated that the officers of the company have sole signatory power on all association accounts (both operating and reserves).⁵⁹

Conclusion

There is considerable agreement that good internal accounting controls would require two signatures on all checks, transfers, and redemptions over a certain dollar amount or, at the least, on all reserve accounts and keeping the majority of funds in the reserve account, with only the minimum necessary to cover monthly expenses in the operating account.⁶⁰ Some sources, including the Community Associations Institute, recommend that association boards retain sole control over reserve accounts.⁶¹ At least one state imposes a signatory policy on condominium associations: California law requires two signatures as a prerequisite for the withdrawal of moneys from an association's reserve accounts.⁶²

Other standard financial controls include such things as separating duties of accounting personnel. It appears that a number of associations may not have the benefit of such internal controls. For many small, self-managed

associations or smaller management companies that may have only one person capable of handling accounting matters, these controls may be difficult to initiate. Indeed, even larger management companies may lack sufficient internal controls.⁶³

This is a difficult area in which to legislate solutions. Mandating financial accounting procedures and other internal controls could produce extreme hardship on a number of condominium associations, requiring an upheaval of their current operations and entailing considerable expense, and could interfere with the contractual provisions between associations and their managing agents. Furthermore, compliance with such requirements may not be easy to verify. At this point in time, the Bureau would suggest, as a more palatable approach, that the issues of financial management and appropriate internal controls be addressed and encouraged in any type of educational effort undertaken of members of the condominium community.

The Bureau also notes a suggestion by one the larger management companies to license all property management companies, establish standard accounting procedures for their use, and institute an examination or verification procedure similar to that established for the examination of financial institutions. It is acknowledged that such a requirement probably would increase management costs to associations and force some management companies out of business.⁶⁴ Furthermore, it would have little effect on the internal controls for self-managed associations. Nevertheless, there is some validity to the argument that there is little sense in requiring condominium managing agents to be licensed real estate brokers when such licensing has little if any relevance to managing condominiums. It would be imminently more logical to require managing agents to possess minimal levels of knowledge and skills necessary and desirable of those persons engaging in the business of managing condominiums. An assessment of the particular knowledge and skills that should be required under a licensing scheme are beyond the scope of this study. If the Legislature wishes to pursue this idea, it could request the Real Estate Commission, with the assistance of the condominium specialist, to consider appropriate licensing requirements.

ACCESS TO FINANCIAL INFORMATION

S.C.R. No. 100, S.D. 1, H.D. 1, specifically asked the Bureau to consider whether owners receive adequate information regarding the use of their maintenance fees. This issue is discussed in Chapter 2. However, it is important to reiterate that access to this and other financial information regarding condominium operations is one of the primary means by which owners can assess whether funds are being expended and managed properly. Such oversight enables them to take appropriate action if funds are being mismanaged.

FIDELITY BONDS

In 1984, the Legislature amended chapter 514A to require fidelity bonds be obtained to protect condominium owners from financial losses caused by fraudulent or dishonest acts by persons handling condominium funds. Specifically, section 514A-84(b) requires a managing agent employed by one or more condominium projects to have a fidelity bond, and section 514A-95(a) requires the agent to show proof of the bond to the Real Estate Commission and provides that any person aggrieved by reason of fraud, misrepresentation, or deceit on the part of the agent may recover from the bond. Similarly, section 514A-84(c) requires self-managed associations to obtain an identical fidelity bond for all persons handling project funds to protect against fraudulent or dishonest acts. The required bond amount is \$500 multiplied by the number of units in the project, or by the aggregate number of units covered by all the managing agents contracts, with a minimum of \$20,000 and a maximum of \$100,000.⁶⁵ The Real Estate Commission is given statutory responsibility for registering managing agents and for monitoring compliance of agents and self-managed associations with the fidelity bond requirements.⁶⁶

The Real Estate Commission's Fidelity Bond Study

Fidelity bonds are not so much a means of exercising control over the use of association funds as they are a means of recouping funds lost through fraud or dishonesty. Nevertheless, they deserve some mention here because they apparently do not provide the protection to association funds intended by the Legislature. Problems relating to the existing fidelity bond requirements have been detailed in the Real Estate Commission's 1988 fidelity bond study which was submitted to the Fourteenth Legislature.⁶⁷ These problems are reviewed here briefly; the reader should consult the full report for an in-depth discussion.

Perhaps the most troubling of the problems mentioned is that many associations are not protected by their managing agent's bond in specific circumstances.⁶⁸ Fidelity bonds generally are intended to protect an employer from theft by employees.⁶⁹ Accordingly, coverage would not extend to financial losses caused by sole proprietors, partners, or principal owners of closely held corporations. Therefore, if the principal owner of a management company steals association funds, coverage would be denied.

Another instance in which an association would not be covered under an agent's bond is if an association board member or employee steals association funds, since these persons are not the agent's employees.⁷⁰ Moreover, in some cases, a managing agent's fidelity bond may be written to cover only the agent's funds and would not include loss of association funds.⁷¹ It also appears that the association, as a third party, would not have a direct claim under a manager's fidelity bond; any claim would be paid by the insurer to the management company, not the association.⁷²

Another noteworthy concern is the study's report that over 42 per cent of the self-managed associations responding to a survey indicated they did not have a fidelity bond.⁷³ Furthermore, even those associations with fidelity bonds may be inadequately protected if their policy excludes coverage of board members who handle association funds on the basis they are not

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"employees" of the association. The study also noted that some management companies and associations reported difficulties obtaining a fidelity bond because of inadequate internal controls.⁷⁴ In addition, the study reported that some companies had deductibles ranging from \$1,000 to \$10,000.⁷⁵

Finally, the study identified several problems with the Real Estate Commission's administration and enforcement responsibilities under the law.⁷⁶ These problems primarily concern inadequate staffing and information data bases that effectively deny the Commission access to timely information on fidelity bond amounts covering both managing agents and self-managed associations. Without such information, the Commission is unable to verify whether agents and self-managed associations have bonds in the required amounts.⁷⁷

The fidelity bond study recommended legislation to address some of these problems, including: (1) the requirement that all condominium associations, regardless of how managed, register with the Commission and obtain a fidelity bond to protect against board members and employees handling association funds and (2) the establishment of a condominium management recovery fund for recompense of associations when the agent's bond does not provide coverage or when losses exceed the coverage amount. None of these proposals were adopted during the 1988 legislative session.

Comments By the Department of Commerce and Consumer Affairs Condominium Specialist⁷⁸

In an effort to provide the maximum possible protection for condominium associations within the acknowledged limitations of the existing law regarding fidelity bonds, the Commission recently has implemented guidelines for fidelity bond requirements. As part of the implementation of these guidelines, the condominium specialist reviewed the files of the approximately 80 active condominium managing agents in the State and discovered that, according to Commission records, about 50 per cent of these managing agents had no current certificate of insurance on file with the Commission. In fact, it turns

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out some of them had a valid fidelity bond policy in force; however, the Commission's records did not reflect this fact.

This discrepancy arises as a result of the managing agents' licenses being renewed biennially, while many insurance certificates seem to be issued annually. Although most managing agents have a valid certificate for the first year of the two-year license term, some fail to send in their certificate for the second year or fail to renew their bond.

Conversations between the condominium specialist and insurance agents regarding the existing fidelity bond requirements reinforce the conclusion reached by the Commission's fidelity bond study that existing bond requirements do not provide adequate coverage for condominium associations. Most agents suggest that requiring a condominium association to obtain its own fidelity bond provides superior protection because a condominium association's own bond usually will cover managing agents who are sole proprietors, partners, or principal owners of closely held corporations. A condominium association also will have a direct right of action against its own bond. Under the present law, the association does not have a direct right of action against its managing agent's fidelity bond, although it does have a right of action against the managing agent.

Furthermore, the condominium specialist confirms the fidelity bond study's conclusion that enforcement of the law requiring self-managed associations to carry bonds is difficult because the Commission lacks information on self-managed projects because they are not required to register with the Commission. Therefore, the Commission's only way of determining compliance is to call every project in the State or physically visit those projects that are not listed in the telephone directory. (Only if a project in question is known to have a managing agent, can it be excluded from the process.) Neither alternative is feasible given the Commission's present number of staff. As a result, the existing fidelity bond requirement for self-managed associations appears to be not only unenforced but unenforceable.

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The fidelity bond study estimated that more than 42 per cent of self-managed associations have no fidelity bond. Although the condominium specialist cannot verify the number of condominiums without bonds, he has spoken with representatives of several associations that acknowledged they have no fidelity bond.⁷⁹

The condominium specialist also confirms that the Commission lacks current data on most condominium projects in the State. Often the Commission has only the initial registration information provided when the condominium was first established. This information frequently is out of date. A partial computerized data base, current up to the end of 1986, was established as part of the fidelity bond study. Unfortunately, as the study itself points out, that data base lacks much pertinent information. In addition, it has not been kept current by the Commission because of insufficient staff and lack of access to computer hardware. Information on new projects is still being typed onto index cards by Commission staff. Furthermore, the Department of Commerce and Consumer Affairs's reregistration process does not require managing agents to update information to reflect projects they currently are managing.⁸⁰

In an attempt to facilitate the updating and maintaining of information and, concomitantly, the ability of the Commission to carry out its administrative and enforcement responsibilities, the Commission intends, once again, to propose legislation requiring registration of all condominium associations. Required registration information will include proof of fidelity bond coverage; names and positions of those persons who handle the association's funds; name of the association's managing agent, if any; the current postal address of the association; and the name, business address, and phone number of a designated contact person for the association. The Commission hopes to use this information to verify that all associations are operating within legal requirements and to educate associations about legal requirements affecting condominiums. The Commission's proposed legislation also will require that all associations with six or more units obtain their own fidelity bond, regardless of whether they employ a managing agent.

Requirements in Other Jurisdictions

Condominium laws in several states require that associations carry fidelity bonds. For example, Florida law requires associations with over 50 units to obtain a bond covering all persons who control or disburse association funds, in the sum of not less than \$10,000 for each person.⁸¹ Under Illinois law, both associations and managing agents must maintain fidelity bonds covering those handling association funds.⁸² The California code, although not actually requiring an association fidelity bond, includes a suggested form for condominium bylaws that contains a provision requiring association officers and employees who handle money to furnish adequate fidelity bonds, at the association's expense.⁸³ Additionally, it should be noted that a number of Hawaii condominium associations' bylaws may require the association to maintain a fidelity bond; it is uncertain, however, how many of these associations actually observe the requirement.

Conclusion

Given the foregoing discussion, amendments to the fidelity bond requirement will be necessary to achieve the protection intended by the Legislature. There appears to be general consensus that requiring all associations to obtain their own fidelity bonds to cover all persons handling association funds will provide greater protection than available under the current law. The Real Estate Commission supported such a bill last year and reportedly will propose a similar bill for the 1989 regular session. A representative of State Farm Insurance Company reports this is accomplished elsewhere by issuing a standard blanket fidelity bond to the association as the named insured and issuing an agent's endorsement to cover the acts of the managing agent up to a specified amount.⁸⁴ The Bureau recommends that the Legislature address the inadequacies of the current fidelity bond requirement and consider requiring all condominium associations, regardless of how managed although possibly excepting those under a certain number of units, to obtain fidelity bonds covering all persons handling association funds. The Legislature also should consider requiring all associations to

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register with the Real Estate Commission to facilitate the Commission's statutory responsibility of ensuring compliance with the bond requirement.

Chapter 4

FINDINGS AND RECOMMENDATIONS

S.C.R. No. 100, S.D. 1, H.D. 1, requested the Bureau to study various problems relating to the governance of condominiums and, if appropriate, to propose feasible means and methods of dealing with such issues more effectively than is being done at present. Although the condominium specialist was a participant of this study, the findings and recommendations herein are solely those of the Bureau.

Findings

The Bureau makes the following findings and conclusions:

1. *The issue of informed condominium association board members and owners pervades a number of other issues and concerns. The presence or absence of knowledge and information on the part of board members and owners necessarily affects all of their actions, decisions, and perspectives and facilitates informed decision-making. The possession of knowledge and information also allows condominium owners to exercise their oversight function of monitoring condominium operations. Accordingly, having access to knowledge and information provides the most viable and reasonable means by which owners can protect their interest and guard against possible abuse of power by those in authority.*

2. Many board members, owners, and even some managing agents either are unaware of or unfamiliar with the laws, rules, and specific documents governing condominiums. Others do not understand their ramifications or misinterpret their provisions. Consequently, many board members and owners do not fully apprehend their respective rights, duties, and responsibilities. Moreover, some first-time condominium residents may be unaware of particular facets of condominium life that differ substantially from single-family home

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ownership. As a result, there may be misunderstanding, dissatisfaction, and unfulfilled expectations surrounding condominium living.

3. Various provisions of chapter 514A, Hawaii Revised Statutes, provide owners a right of access to information and documents relating to condominium operations and management. In addition, section 514A-83.1 requires that all board of directors meetings be open to owners and allows them to participate unless a majority of the quorum of the board of directors votes otherwise. There is, however, no requirement that notice be given of those meetings. The section also strictly limits executive board sessions to discussions of personnel matters or litigation in which the association is or may become involved.

4. It would appear that the general intent of these provisions is to preserve the right of owners to know how their association is being managed by opening up the decision-making process to the scrutiny and participation of owners. The access provided by these provisions acts as a restraint on the authority of boards and managing agents and thus provides a safeguard against possible abuse of that authority.

5. Nevertheless, there are times when boards and or managing agents fail to comply with these statutory provisions. The reasons for noncompliance may include: ignorance of or unfamiliarity with the requirement, a misunderstanding or difference of opinion in interpreting the provision, or simply a refusal to comply.

6. There is a clear and compelling need to educate members of the condominium community concerning their respective rights, duties, and responsibilities and the specific provisions of laws, rules, and documents governing condominiums. This increased awareness could greatly reduce misunderstandings and dissatisfaction and help to alleviate a number of the problems that arise with respect to condominiums.

7. Apparently some condominium disputes arise over differing interpretations of what is intended or required by various sections under part V of chapter 514A. In some instances, rules setting forth guidelines or procedures could eliminate areas of ambiguity or misunderstanding and resolve disputes *more appropriately and more efficiently than amending the statute*. It is unclear, however, whether the Real Estate Commission, which currently has jurisdiction over condominiums, has general rulemaking authority under part V, other than possibly with respect to sections 514A-84, 85, and 95.

8. Where boards and/or managers do not comply with provisions clearly granting a right of access to information or documents, owners should have a rapid, economical, and effective means of enforcing compliance. For the most part, however, owners involved in condominium disputes have little option other than private legal action, which is prohibitively expensive for many; for others the nature of the dispute is insufficient to justify the cost of litigation. In any case, because of the nature of the dispute, legal resolution may come too late to be effective.

9. Section 514A-121 provides for mandatory arbitration as a quicker, less costly forum for resolving condominium disputes. Apparently, arbitration is not as effective a dispute resolution forum for condominium disputes as it should be, however, because many of these disputes that arise are not being arbitrated. Presumably this is because they fall within one of the statutory exceptions to mandatory arbitration or because the disputants are unaware, or are not advised, of the availability of arbitration.

10. A number of condominium disputes fall into the exception for actions to collect assessments that are liens or subject to foreclosure. Frequently these actions have nothing to do with inability of an owner to pay, but rather an owner has withheld maintenance payments (apparently often unaware of the ramifications of this action) because of an underlying dispute that has nothing to do with the maintenance fee or other assessment. Consequently, there is a need to publicize more widely the availability and advantages of arbitration

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and to advise and educate owners about the effects of their actions on the ability to arbitrate.

11. Additionally, it may be necessary to undertake other measures to ensure compliance with provisions of chapter 514A that grant owners a right of access to information about condominium operations and management.

12. It is questionable whether the Real Estate Commission has authority to enforce compliance with part V of chapter 514A. Moreover, irrespective of the question of its authority, the Commission, with its myriad of other responsibilities, lacks adequate staff and resources to carry out effectively any additional functions or responsibilities.

13. The position of condominium specialist was created as a compromise to avoid creation of a condominium commission and with the hope that the position would solve a number of problems (sought to be solved each year by proposed legislation) by disseminating information about the present condominium laws and by taking appropriate action in certain cases. The position is only temporary, however, has no staff or resources, and lacks any means of authority to compel compliance with the law.

14. Although many associations undergo an annual audit, it appears a number either waive, are unaware of, or ignore the requirement. Those associations whose management process is more formalized are more likely to undergo an audit. Many managing agents see the audit as a protective measure for themselves, also, and therefore may be more likely to advise their client associations to have the audit. Very small associations, with few units over which to spread the cost of an audit, may be less likely to undergo an audit.

15. A financial audit is an opinion on the fairness of the presentation of a financial statement in accordance with generally accepted accounting principles. As such, it provides reasonable assurance that the financial statement is free of material misstatements. To this extent, it is an effective

and affordable safeguard. It is not, however, a guarantee of accuracy or an endorsement of an entity's policy decisions, use of resources, or adequacy of internal financial controls.

16. The American Institute of Certified Public Accountants is in the process of developing standards for auditing and accounting for condominium associations. When adopted, these standards will be generally accepted accounting principles for auditors of condominiums and may necessitate changes in current accounting and auditing practices.

17. A number of standard internal accounting procedures and systems exist that provide good financial controls through checks and balances. The degree to which they are practiced by associations and managing agents is difficult to determine, however.

18. One of the primary internal control measures involves restricting access to association funds. This may be accomplished by requiring countersignatures on all checks over a certain dollar amount or by maintaining a minimum balance in an operating account sufficient to cover monthly expenses, with all remaining funds deposited in a reserve account that requires two countersignatures for any withdrawal or transfer of funds. Although some associations have instituted this control, some have not.

19. Internal financial controls is a difficult area in which to legislate. Furthermore, mandating that associations practice certain internal controls might require some associations to overhaul their entire financial and accounting system and could result in considerable expense to condominium owners.

20. Currently the law requires every condominium managing agent to be licensed as a real estate broker or a corporation authorized to do business as a trust company and to register with the Real Estate Commission. In practice, however, the Commission requires only one broker to be connected to each management company registering with the Commission; each individual

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employed by the company as a managing agent is not required to be a broker also. The laws governing condominiums and the management of condominiums have become increasingly complex and specialized. It generally is agreed that the knowledge and qualifications necessary to be a broker have little relevance to condominium management. Accordingly, the requirement that managing agents be licensed as brokers makes little sense and is not observed in practice (except for one token broker) by the Real Estate Commission.

21. Present statutory requirements with respect to fidelity bonds for managing agents do not provide sufficient protection for association funds. In addition, some managing agents may not even have current fidelity bonds. Also, a number of self-managed associations may not have fidelity bonds as required by statute. It appears some self-managed associations may be unaware of the requirement; others are unable to obtain fidelity bonds.

22. Although the Real Estate Commission has statutory responsibility for the fidelity bond requirement, it lacks the ability to oversee and enforce compliance. This primarily is because it lacks current data on condominiums and managing agents: the Commission has insufficient staff and resources to enable it to update information on managing agents registered with the Commission and has little or no information on self-managed associations because they are not required to register with the Commission in the first place.

Recommendations

The Bureau makes the following recommendations:

1. Education of the Condominium Community

There is a clear, and in many cases a compelling, need to educate members of the condominium community concerning: their respective rights, duties, and obligations; the legal requirements imposed by statute or specific documents governing condominiums; and various other issues including but

not limited to good financial management (including planning for major future repairs and replacements), sufficient internal financial controls, and the availability of mandatory arbitration for resolution of condominium disputes. The Bureau recommends that the Real Estate Commission, in conjunction with the condominium specialist and possibly with the assistance of others involved with condominium issues (as suggested in Chapter 2 of this report), develop educational materials in the form of handbooks, manuals, videos, or seminars that will advise and enlighten members of the condominium community concerning, at a minimum, the above enumerated issues. To enable the Commission to accomplish this undertaking, the Bureau also recommends that the Legislature allocate sufficient resources for this specific purpose.

2. Notice of Meeting of Board of Directors

Section 514A-83.1 requires all board of directors meetings, other than executive sessions, to be open to all association members; however, there is no notice requirement. Thus, although owners may attend meetings, they may not know when and where the meetings will be held. Consequently, the Bureau recommends that section 514A-83.1 be amended to provide that adequate notice of the time and place of all board of directors meetings be posted conspicuously on the condominium property at least 48 hours in advance of the meeting, except in an emergency.

3. Rulemaking Authority Over Part V of Chapter 514A

Because it is unclear whether the Real Estate Commission has general rulemaking authority over part V of Chapter 514A, the Bureau recommends that the Legislature enact a new section to part V clearly granting authority to the Real Estate Commission to adopt, amend, or repeal whatever rules it considers necessary to effectuate fully the purpose of part V. This authority should specifically include the ability to adopt rules forbidding acts or practices deemed by the commission to be detrimental to accomplishing the purpose of part V and imposing whatever requirements as will better enable the Commission to enforce part V and rules adopted thereunder.

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4. Enforcement Authority Over Part V of Chapter 514A

The Commission also lacks clear authority to enforce compliance with any sections under part V (again, except possibly sections 514A-84, 85, and 95) and, given its other responsibilities, lacks the ability to do so with its current level of staffing and resources. Therefore, the Bureau recommends the creation of an agency, either as an arm of the Real Estate Commission or as a separate division with the Department of Commerce and Consumer Affairs, with powers and duties similar to that of Florida's Bureau of Condominiums, described in Chapter 2 of this report, and with sufficient staff and resources to perform effectively. (If a separate division is created, all jurisdictional authority and responsibility for condominiums, including the rulemaking and educational functions recommended herein should reside with that division instead of with the Real Estate Commission.) If the Legislature feels such an approach is unwarranted at this time, at the very least, the Legislature should make the condominium specialist a permanent position, clearly and realistically define the duties and authority of the position, and provide the position with sufficient funding for support staff and equipment.

5. Amendment to Section 514A-96

An audit of association financial statements constitutes an effective and affordable safeguard to the extent it provides reasonable assurance that the financial statements are fairly presented. To ensure that a greater number of associations receive the benefit of an annual financial audit, the Bureau recommends that the Legislature amend section 514A-96 to eliminate the ability of an association to waive the audit. If the Legislature finds that the cost of an audit is too burdensome for those associations that only have a few units over which to spread the cost, it could allow only those associations with less than a certain number of units or with less than a certain dollar amount of gross income to waive the audit. If the Legislature favors this latter approach, it may want to consider at least requiring these associations to undergo a financial review every several years (e.g., every 3 or 5 years).

6. Countersignature Policy with Respect to Association Funds

Countersignatures on checks or transfers over a certain sum of money or for other than normal operating expenditures is a standard internal financial control practiced by most businesses. The absence of this standard practice may constitute evidence of negligence involving mishandling of funds. Accordingly, although the Bureau does not recommend mandating by statute the use of countersignatures or other internal controls for association funds, the Legislature may want to consider establishing a legal rebuttable presumption of negligence that will arise in any suit involving the propriety of management of association funds if there is no established countersignature policy with respect to those funds (e.g., any two signatures required on checks or fund transfers over a certain dollar amount or on an association's reserve account).

7. Licensing of Managing Agents

If the State is going to undertake to regulate condominium managing agents, the requirements should have some rational relationship to condominium management. Therefore, the Bureau recommends that the Legislature repeal the broker license requirement for managing agents and instead consider requiring all managing agents to be certified and licensed. As a preliminary step, the Legislature should fund a study under the auspices of the Real Estate Commission or the condominium specialist to determine what education, skills, and experience are necessary and desirable for those persons engaged in the business of managing condominiums.

8. Bonding Requirement

Current fidelity bond requirements for managing agents do not provide the protection to associations that was intended by section 514A-84. Requiring associations to obtain a fidelity bond that covers all persons handling association funds, including managing agents, appears to provide more protection than the current requirement. Consequently, the Bureau

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suggests that the condominium specialist with the assistance of the insurance commissioner investigate the availability of bonds meeting this requirement and, if available, that the Legislature consider enacting this requirement.

9. Registration Requirement

The Real Estate Commission is unable to fulfill its current responsibilities with respect to the administration and enforcement of bonding requirements under section 514A-84 because it lacks any information about self-managed condominiums and lacks current data on associations managed by managing agents. To facilitate the ability of the Commission to monitor and enforce bonding requirements, the Bureau recommends that the registration requirement of section 514A-95 be amended to require that all associations, regardless of how managed, register with the Commission. Additionally, the Bureau recommends that the Commission determine exactly what information is necessary for it to administer and enforce the bonding requirement and change its registration and renewal forms accordingly to facilitate collection of this information. Also, to ensure this information is kept current and is easily accessible, it should be computerized. Therefore, the Bureau recommends that sufficient funds be provided to accomplish this.

FOOTNOTES

Chapter 1

1. This figure was supplied by the Legislative Information Systems Office of the Legislative Reference Bureau and does not include bills still "alive" at the end of 1987, resolutions introduced in 1988 relating to condominiums, or other bills tangentially affecting chapter 514A of the Hawaii Revised Statutes.
2. The possibility of surveying condominium residents was discussed briefly but was dismissed after it was discovered that the Real Estate Commission has insufficient current data to produce an accurate mailing list.
3. During his first 5 months as condominium specialist, Mr. Morris received specific inquiries from approximately 220 persons and spoke with a multitude of others at various meetings and conferences he attended.
4. The panel was formed in 1987, with the endorsement of Senator Steve Cobb and Representative Mazie Hirono, to meet with legislators to discuss areas of concern and proposed legislation relating to condominiums. The panel is composed of representatives of the following groups and organizations: American Arbitration Association; Horizontal Property Regime Committee, Real Property and Financial Services Section, Hawaii State Bar Association; Hawaii Council of Association of Apartment Owners; Hawaii Independent Condominium and Cooperative Owners; Management Companies; and the Real Estate Commission.
5. Samuel B. K. Chang, Director of the Legislative Reference Bureau, raised concerns about the timetable of the study during hearings on S.C.R. No. 100 (an earlier version of the final resolution) before the House Committees on Consumer Protection and Commerce, Intergovernmental Relations, Judiciary, and Legislative Management. Mr. Chang basically questioned whether reporting to the 1989 legislature would allow sufficient time for data gathering, especially since the condominium specialist, who would play a critical data collecting role and whose effectiveness would depend upon sufficient time for the public to become adequately informed of the new position, probably would not be hired until at least July 1, 1988. Mr. Chang's recommendation that the study be submitted prior to the convening of the Regular Session of 1990 was not followed, despite earlier concern expressed by the Senate Committee on Consumer Protection that a Real Estate Commission report, which included several issues relating to condominium governance, was not submitted until after the beginning of the 1988 Regular Session, thus allowing for insufficient time for review, comment, or proposed legislation. Mr. Chang's testimony appears in Appendix C.
6. See e.g., A Study of Problems in the Condominium Owner-Developer Relationship, Office of Consumer Protection, Office of the Legislative Reference Bureau, Real Estate Commission, (Honolulu: 1976).

Chapter 2

1. See Hawaii Rev. Stat. §92-1.
2. See generally, D. Wolfe, Condominium and Homeowner Associations That Work, (The Urban Land Institute & The Community Associations Institute) 1-5; "Condominium Living In Florida," Department of Business Regulation Division of Florida Land Sales, Condominiums & Mobile Homes, Bureau of Condominiums (Brochure 1985).
3. See 1988 Haw. Sess. Laws, Act 278, establishing the temporary position of condominium specialist. (Appendix B).
4. This section was prepared by John Morris, Condominium Specialist with the Department of Commerce and Consumer Affairs, and has been edited by Bureau staff primarily for stylistic purposes.
5. Hawaii Rev. Stat. §§514A-81 to 96.
6. Both Florida's and Illinois's condominium property regime law specify that officers and members of a condominium association board of directors have a fiduciary duty to condominium owners. Fla. Stat. §718.111(1)(a); Ill. Rev. Stat. ch. 30, §318.4(q). The Hawaii Revised Statutes contains no similar provision, although section 514A-95 does address the fiduciary duty of a managing agent with respect to property managed by the agent.
7. Hawaii Rev. Stat., §514A-82(a)(1)(F) requires the association bylaws to specify which of the powers and duties granted to the board may be delegated by the board to a manager or managing agent.
8. Parliamentary manuals lack detailed information on crucial areas such as proxies. In fact, many manuals frown on the use of proxies at a meeting where members are present in person. In contrast, in most condominiums, proxies are a necessary and important part of the decision-making and voting process. Associations usually rely heavily on proxies for elections and voting, even if members are present in person. Simple, more concise summaries of parliamentary procedure tailored specifically to condominium meetings might benefit owners and board members.
9. Hawaii Rev. Stat. §514A-83.3.
10. Hawaii Rev. Stat. §514A-83.4.
11. Hawaii Rev. Stat. §514A-84.5.

12. Hawaii Rev. Stat. §514A-85.
13. Hawaii Rev. Stat. §514A-86(c).
14. See note 4, supra.
15. General Henry M. Robert, Robert's Rules of Order (Scott, Foresman, and Company 1970).
16. See Hawaii Rev. Stat. §514A-85.
17. In contrast, the Florida law requires the keeping of a "current account and monthly, bimonthly, or quarterly statement of the account for each unit designating the name of the unit owner, the due date and the amount of each assessment, the amount paid upon the account, and the balance due" which is open to inspection by owners or their representatives at all reasonable times. Fla. Stat. §718.111(12), (11b).
18. Hawaii Rev. Stat. §514A-83.1 was amended by Act 341 of the 1988 Haw. Sess. Laws; prior to the amendment, the presumption was that owners were not allowed to participate in board discussions unless expressly authorized by a majority of the board members present at the meeting.
19. Several other states expressly require that notice of board of directors' meetings be given to owners: See Fla. Stat. §718.112(2)(c) (adequate notice posted conspicuously on the project at least 48 hours in advance, except in an emergency); Ill. Stat. Ann. ch. 30, §318(a)(9) (notice mailed or delivered, unless waived, and posted conspicuously on the project 48 hours in advance; also allows owner to record meeting by tape, film, etc.); Or. Rev. Stat. §94.164(3)(a) (where majority of units are principal residences of the occupants, requires posting of notice on property at least 3 days prior to the meeting, except for emergency meetings).
20. Hawaii Rev. Stat. §514A-83.1(b).
21. Id.
22. Illinois is the only state of which the Bureau is aware that specifically allows telephonic board meetings; however, telephonic meetings are not permitted in projects in which a majority of the units are the principal residences of the occupants. Ill. Rev. Stat. ch.30, §318(a)(9).
23. Hawaii Rev. Stat. §514A-82(a)(17) requires all meetings of the association of apartment owners to be held at the address of the condominium project or elsewhere in the State as determined by the board.
24. A similar educational effort already has been undertaken to explain the Hawaii Residential Landlord-Tenant Code. The Office of Consumer Protection has prepared a handbook informing landlords and tenants of their rights and responsibilities under the law.
25. See Fla. Stat. §718.501 (power to enforce and ensure compliance with laws and rules relating to the development, construction, sale, lease, ownership, operation, and management of the residential condominium projects).
26. Annual Report of the Bureau of Condominiums July 1985 (Department of Business Regulation, Division of Florida Land Sales, Condominiums and Mobile Homes) at 7 [hereinafter cited as Florida Annual Report].
27. Id.
28. Id.
29. The number of inquiries are considerable. For example, statistics for a one year period reveal that the staff received over 1,500 written inquiries and 10,000 telephone inquiries concerning condominiums and cooperatives. Id.
30. Id.
31. This incident was reported to the condominium specialist.
32. Letter from Deputy Attorney General Randall Y. Iwase to Dr. Mary G. F. Bitterman, Director of Commerce and Consumer Affairs, March 5, 1981. See Hawaii Rev. Stat. §§514A-47 to 514A-49.
33. Even the more affluent may find a legal suit uneconomical unless prevailing in the suit is considerably more important to them than their investment in legal fees and other court costs. Cf. Johnson, Kantor, & Schwartz, Outside the Courts: A Survey of Diversion Alternatives In Civil Cases (Denver: National Center for State Courts 1977) at 4.
34. See, e.g., Thomas W. Church et al., Justice Delayed: The Pace of Litigation in Urban Trial Courts (Williamsburg: The National Center for State Courts, 1978); Action Committee to Reduce Court Costs and Delays, Attacking Litigation Costs and Delay (Chicago: American Bar Association, 1984).
35. Hawaii Rev. Stat. §514A-121(a). The average time from filing to disposition by arbitration of condominium disputes currently is 125-128 days. The typical filing fee by the moving party requesting arbitration in condominium disputes is \$250, although it can vary. Other costs, such as the arbitrators' fee (depending upon the number of hours spent) and extra costs for written findings and conclusions, could run considerably higher. This also does not include attorneys' fees. Interview with Keith Hunter, District Director of the American Arbitration Association in Hawaii, December 21, 1988.
36. Id.
37. Id.
38. Hawaii Rev. Stat. §514A-121(b)(5).
39. This scenario has been observed on a number of occasions by both Mr. Morris, the Condominium Specialist, and Mr. Hunter, see note 35 supra.
40. See Hunter, note 35 supra. Mr. Hunter estimated that while most boards, associations, and

managing agents are represented in arbitration by an attorney, only slightly more than 50% of the owners are represented by an attorney at arbitration.

41. See e.g., H.B. No. 1287, Fourteenth Legislature, 1988, State of Hawaii; House Standing Committee Report 901 on S.B. No. 2501. S.D. 2, H.D. 1, Fourteenth Legislature, 1988, State of Hawaii.
42. Fla. Stat. §718.501.
43. Id.
44. Florida Annual Report, *supra* note 26, at 8. The experiences of the condominium specialist and Mr. Hunter appear to support this finding.
45. Id. at 5-6.
46. See note 32 *supra* and accompanying text.
47. The Act creating the condominium specialist position made the position effective only until June 30, 1990. Furthermore, it did not grant the condominium specialist jurisdiction over condominiums, but only authorized the specialist "to assist consumers with information, advice, and referral" concerning condominiums. See note 3 *supra*.

Chapter 3

1. It is unclear what is meant by the term "treatment" of association funds; for purposes of this study the Bureau has interpreted it as referring to the management of those funds.
2. For purposes of this report, the reference to condominium managers include their employees.
3. 1985 Haw. Sess. Laws, Act 212.
4. 1986 Haw. Sess. Laws, Act 96. The present version of section 514A-96 reads as follows:

§514A-96 Audits. The association of apartment owners shall require a yearly audit of the association financial accounts and no less than one yearly unannounced verification of the association's cash balance by a public accountant; provided that the yearly audit and the yearly unannounced cash balance verification may be waived by a majority vote of all apartment owners taken at an association meeting. [L 1985, c 212, §1; am L 1986, c 96, §1]
5. See House Standing Committee Report No. 277 on House Bill No. 1795, Thirteenth Legislature, 1986, State of Hawaii.
6. Hawaii Real Estate Commission, Department of Commerce and Consumer Affairs, A Fidelity Bond Study On Condominium Managing Agents And Self-Managed Condominium Associations, January 1988, at 31 [hereinafter cited as Fidelity Bond Study]. Of 10 managing agents interviewed, 3 indicated most clients waived the annual audit,

one indicated half of the company's clients waived the audit, and 6 indicated that all or a majority of their clients undergo the annual audit. Id. at 21.

7. Id. at 31. Because of the low response rate by self-managed condominiums to the Real Estate Commission's survey, the study's authors acknowledge that the sample response may not be representative of the population of self-managed condominium projects. See id. at 10-13.
8. For purposes of this report, the term "auditor" is used to refer to public accountants and certified public accountants performing an audit under 514A-96.
9. These figures also usually include the cost of preparing the association's annual income tax returns.
10. These managers contend that stiff competition, especially among smaller management companies, for association clients is the reason why they say smaller companies without adequate resources are stretched too thin and try to cut too many corners to provide management services at a cheaper rate, with the end result being a loss in quality of service. They welcomed more controls on managers, such as certification, as a means of eliminating those companies that, in their opinion, provide only marginal service at best.
11. The tendency of associations that have annual audits also to undergo the cash balance verification was confirmed by an auditor, who annually audits about 40 condominium associations. He reported that 90 per cent of the associations undergo both the audit and an annual cash balance verification.
12. The same board member was unaware that self-managed projects were required by law to have a fidelity bond. For a discussion of fidelity bonds, see notes 65-84, *infra*, and accompanying text.
13. This situation is but one illustration of the Real Estate Commission's lack of current information on condominiums. Without current information, and the resources to obtain and computerize the information, the Commission can not be expected to monitor and enforce compliance with chapter 514A even if the legislature were to authorize the commission to do so. For further discussion of this problem, see note 80 and accompanying text.
14. American Institute of Certified Public Accountants, The New Auditor's Report (New York: Pamphlet 022014) undated [hereinafter cited as AICPA Pamphlet].
15. Id.
16. See e.g., Statements on Auditing Standards (SAS) No. 58, Reports on Audited Financial Statements.
17. "Misstatements are considered material if they are significant enough to make a difference in

- the decisions of a reasonable financial statement user." AICPA Pamphlet, supra note 14.
18. D. Carmichael, "The Auditor's New Guide To Errors, Irregularities, and Illegal Acts," Journal of Accountancy 40, 44 (September 1988).
 19. These tests include confirming bank balances and accounts receivable, making physical inspections, and tracing transactions to invoices and evidence of payments. Community Associations Institute, Tips To Help You Protect Your Community Association's Funds, (Alexandria: Pamphlet) 1987 [hereinafter cited as CAI Pamphlet].
 20. AICPA Pamphlet, supra note 14.
 21. Id.
 22. Carmichael, supra note 18, at 42.
 23. Id.
 24. Task Force on Accounting for Common Interest Realty Associations, American Institute of Certified Public Accountants, Proposed Audit and Accounting Guide: Common Interest Realty Associations. August 31, 1988 [hereinafter cited as AICPA Exposure Draft].
 25. Id. see Introductory Letter to the Draft. Comments on the draft were being accepted by the AICPA Accounting Standards Division up until December 31, 1988.
 26. Conversation between Karen Silverstien, member of the Hawaii Society of Certified Public Accountants' Committee on Accounting and Auditing Standards, and Charlotte Carter-Yamauchi, February 10, 1989.
 27. AICPA Exposure Draft, supra note 24, at 16. For some associations, financial statements presented on a cash basis may not differ substantially from those presented on an accrual basis. If there are no material differences, the financial statements are in conformity with generally accepted accounting principles. If such statements differ materially from statements presented using an accrual basis, the financial statements are "not in conformity with generally accepted accounting principles and are considered to be prepared on an other comprehensive basis of accounting". Id. at 17.
 28. See, e.g., The Urban Land Institute and the Community Associations Institute, Financial Management of Condominium and Homeowners Associations, (Washington: D.C.) 1976 at 27. There is some difference of opinion over which accounting method is best for condominiums. The cash method is simple to set up, requires less complex record keeping, is easier for laypersons to understand, and may be more suitable for smaller associations; it does not, however, reflect uncollected income and unpaid bills. Thus the major drawback to the cash method of accounting is that it may not accurately portray the financial condition of the association and frequently may be misleading when income is recorded for services that will be paid for in the future.
 29. It should be noted that changing an association's accounting method from a cash basis to fund basis, if that is the final recommendation of the AICPA, would likely entail some extra expense to the association. Because there would be no previous financial statement under the fund accounting method for comparison, the auditor probably would have to recall the preceding financial statement and restate it on a fund accounting basis in order to provide a basis for comparison.
 30. AICA Exposure Draft, supra note 24, at 13-15.
 31. See, Id. at 13.
 32. Cal. Civil Code §1365(a)(3) and (4) (Deering).
 33. Fla. Stat. §718.112(2)(f)(2).
 34. Or. Rev. Stat. §294.072.
 35. Cal. Civil Code §1365(a)(1) (Deering).
 36. A review is somewhat less than an audit. In a review, an accountant examines record keeping practices and accounting policies and analyzes the statements as to their reasonableness. The accountant also prepares disclosures on unusual items or trends that may require explanation. See CAI Pamphlet, supra note 19.
 37. Cal. Civil Code §1365(b) (Deering).
 38. Ala. Code tit. 35, §8-10(4).
 39. Virginia Code §55-79.74:1.
 40. Alaska Stat. §34.07.280(b).
 41. Fla. Stat. §718.111(12)(a)(11).
 42. Id. at §718.501(1)(j).
 43. Id. at §718.111(14).
 44. AICPA Pamphlet, supra note 14.
 45. The 1988, fidelity bond study expressed concern that some managing agents commingle the funds of associations that they manage with other client associations or with their own funds. Fidelity Bond Study, supra note 6, at 21. Interviews by Bureau staff confirmed that at least one large property management company uses a trust account in which all client association funds are deposited and from which all bills are paid. One check is written to each vendor (e.g., a utility company) for the total amount due from all associations participating in the trust account, with the amount charged to an individual association shown on the check stub. The trust account can be visualized as a "pie shape" with the accounts of the individual associations forming "slices of the pie." Separate journals are kept for each association to account for all income and expenses, and each association's funds are insured with FDIC up to the full \$100,000. The advantage of the trust

account to the client association is that the management company pays for all charges associated with the account, including the cost of the checks. The advantage to the management company is that it writes only one check to each vendor monthly instead of over 200 separate checks. The company also receives all interest from the account.

A number of person with whom staff and the condominium specialist spoke (including representatives of other management companies) felt the company was benefiting unfairly by using the trust account and retaining the interest earned thereon. It appears, however, that this is a contractual issue between the company and its clients; during the management contract negotiations, the association has the option of choosing to maintain a separate account. If the association chooses this option, it pays all bank charges and pays the company \$75 more monthly for the extra administrative costs associated with separate accounts, but it earns the interest on the account. However, because all association accounts (trust account and separate accounts) are swept twice monthly, at which time all funds except those necessary to pay remaining monthly bills are transferred to the individual association's reserve account, the balance in an individual account normally earns less interest than the total amount of bank charges. As a result, few associations realize a financial advantage in choosing an individual account over the trust account. This reportedly accounts for why approximately 90% of the management company's client associations choose to participate in the trust account.

According to one auditor, the real concern with the trust account, in terms of safeguarding association funds, is not with who earns the interest but instead is that auditing the trust account is more difficult than auditing an individual account because there is no paper trail to evidence payments made by an individual association. The auditor conceded on the other hand that, unlike many property management companies, this particular company is large enough to have good internal controls which makes the audit easier. Still, he recommends separate accounts for each association because they provide more accountability.

46. See CAI Pamphlet, supra note 19; Letter from Eugene M. Saulcy, State Farm Insurance Company, to John M. Morris, November 29, 1988 [hereinafter cited as Saulcy].
47. Colleen C. Sakai, Ownership Patterns of Land Beneath Hawaii's Condominiums and Cooperative Housing Projects, Legislative Reference Bureau, Report No. 6 (Honolulu: 1987) at 13.
48. See Fidelity Bond Study, supra note 6, at 31; Saulcy, supra note 46.
49. Fidelity Bond Study, supra note 6, at 31.

In determining whether an association has sufficient internal controls, at least one insurance company looks at, among other things, whether: the managing agent maintains separate

records and bank accounts (as opposed to commingling client accounts) for each client association to enable each to track and reconcile its account at any time; the association has two bank accounts: an operating checking account funded monthly only in an amount sufficient to pay normal, expected monthly expenditures and a reserve account for all excess funds; the board of directors control access to the reserve account; countersignatures are required on checks written on the operating account or on checks written over a certain amount. Saulcy, supra note 46.

50. Generally, an association will have two separate bank accounts: a checking account for operating expenses and a reserve account (usually for major building maintenance or capital improvements). Typically, persons having access to these accounts might include the managing agent, board members (usually an officer of the board), or possibly association employees (such as a general manager or accountant of a self-managed association or possibly a resident manager of an association that also has a managing agent).
51. Fidelity Bond Study, supra at 31.
52. Id. at 21 and 31.
53. Id. at 31.
54. Id.
55. Since these interviews were limited in number, the reader is cautioned that the impressions might not necessarily reflect the actual practice of the majority of associations or management companies.
56. There are of course exceptions with respect to a company's individual client associations.
57. A representative of one management company pointed out that a few of their client associations that retain sole control over their operating expenses (after having lost money in the past due to theft on the part of a prior managing agent) and require two board members' signatures on all checks over \$500, do not have fidelity bonds that cover board members handling association funds. As a result, their signatory policy provides little real protection in the event the two board members who are authorized to sign checks conspire to steal the association's funds. See discussion at notes 65-84 infra.
58. The representative contended that, although a dual signatory policy would appear to provide a certain amount of protection, of a number of banks, especially smaller ones, would not want to be responsible for enforcing dual signature accounts. Due to time constraints, no attempt has been made to survey banks to determine their policy with respect to this.
59. The company officers are a husband and wife.
60. See note 46 supra and accompanying text.

61. CAI Pamphlet, supra note 19.
62. Cal. Civil Code §1365.5(b) (Deering).
63. See text following note 49 supra.
64. See discussion at note 10 supra.
65. The actual language of both subsections (b) and (c) of section 514A-84 relating to the minimum and maximum amount of bond contains a patent error and is as follows: "the minimum amount of bond required by this subsection shall not be less than \$20,000 nor greater than \$100,000."
66. See Hawaii Rev. Stat. §§514A-84 and 514A-95.
67. See Fidelity Bond Study, supra note 6.
68. Id. at 29.
69. Generally, an insurance company will not insure an owner against the possible theft by him of his own funds. The study also found that a surety bond may be the more appropriate vehicle to protect associations from dishonest acts of managing agents, but it concluded such a bond is impractical because of its excessive expense and limited issuance. Id. at 35.
70. They might be covered if the agent has a special rider on the agent's policy or if the association has its own policy that specifically covers board members as well as employees.
71. Fidelity Bond Study, supra note 6, at 20.
72. Id.
73. See Id. at 6-7 and 10, explanation.
74. See id. at 16 and 20. See notes 48-49 and accompanying text.
75. Fidelity Bond Study, supra note 6, at 19.
76. See notes 65-68 supra and accompanying text.
77. With respect to self-managed associations, currently there is no registration requirement. As a result, the Commission has no way of determining their compliance with the bonding requirement. With respect to managing agents, subsequent to their initial registration with the Commission, there is no systematic collection of current data identifying the projects (and thus the number of units) they manage. Fidelity Bond Study, supra note 6, at 28-29. See also note 81 infra and accompanying text.
78. This section was prepared by John Morris, Condominium Specialist with the Department of Commerce and Consumer Affairs, and has been edited by Bureau staff primarily for stylistic purposes.
79. For example, a four unit and a seven unit project on Oahu apparently have no bond; a 13 unit project on the Big Island has no bond because it allegedly could not obtain one. Also, a 90 unit project on the Big Island does not have a bond because the board was unaware that a bond was required for self-managed projects.
80. The Commission's lack of information concerning condominiums has been highlighted as a result of the adoption of section 514A-82.1, during the 1988 legislative session. This section allows condominium boards of directors to obtain background information on certain prospective association employees, provided the prospective employee gives written authorization. Access to information through the criminal justice data center has in the past been restricted to government agencies and certain other designated entities. (See Hawaii Rev. Stat. §§846-9 and 846-10.) Accordingly, the criminal justice data center has requested the Commission to assist it in verifying that persons requesting criminal history information on an individual are authorized to represent the association. Given the Commission's lack of current information on condominium associations, however, the Commission cannot verify that individuals seeking information on behalf of an association are representing the board or manager. In the absence of sufficient safeguards conceivably, section 514A-82.1 of the Hawaii Revised Statutes could be used for purposes other than intended, such as to obtain background information on prospective tenants or non-association employees.
81. Fla. Stat. §718.112(2)(j).
82. Ill. Rev. Stat. ch. 30, §381(g).
83. Cal. Civil Code §1355 (suggested forms) (Deering).
84. The usual amount does not exceed \$100,000. The representative also notes that it is necessary to amend the language of the standard policy because acts of "agents" usually are specifically excluded. Saulcy, supra note 46.

SENATE CONCURRENT RESOLUTION

REQUESTING A STUDY OF THE PROBLEMS OF CONDOMINIUM GOVERNANCE.

WHEREAS, there are many condominium developments in the State; and

WHEREAS, the number of legislative bills in recent years which relate in some manner to the construction, equipage, maintenance, financing, disposition, sale, rental, and leasing, of condominiums number over one hundred; and

WHEREAS, the large number of legislative bills which continue to be introduced each legislative session indicates continuing concern with current condominium governance and many other condominium issues; and

WHEREAS, it would be in the public interest to survey, collect, and analyze the variety of factors at work in the issues confronting condominium governance; now, therefore,

BE IT RESOLVED by the Senate of the Fourteenth Legislature of the State of Hawaii, Regular Session of 1988, the House of Representatives concurring, that the Legislative Reference Bureau is requested to conduct an interim study of the various problems concerning the governance of condominiums, and to propose feasible means and methods of dealing with such issues more effectively than is being done at present, if appropriate; and

BE IT FURTHER RESOLVED that the study shall address various issues relating to grievance and management of condominium, including the following:

- (1) Are there reasonable controls on the use and treatment of condominium association funds?
- (2) Are current fiscal audits of association funds adequate?
- (3) Do owners receive adequate information regarding use of their maintenance fees?

- (4) Is the process for selection of association boards of directors fair and reasonable?
- (5) Are there adequate checks and restraints to prevent the abuse of power by board members, managing agents, or managers?
- (6) Are there adequate avenues of information to boards and owners concerning condominium laws and regulations?
- (7) What is the extent of grievance problems experienced by condominiums with reference to items one through five above?; and

BE IT FURTHER RESOLVED that the study shall also address other comments and concerns that interested parties may provide; and

BE IT FURTHER RESOLVED that the Real Estate Commission is requested to fully cooperate with the Legislative Reference Bureau and to make available to the Bureau any and all records and other information which the Bureau considers pertinent to this study; and

BE IT FURTHER RESOLVED that the Condominium Specialist to be employed pursuant to S.B. No. 2501 shall be a full participant in the study; and

BE IT FURTHER RESOLVED that the Legislative Reference Bureau submit a report of its findings and recommendations to the Legislature no later than twenty days prior to the convening of the Regular Session of 1989; and

BE IT FURTHER RESOLVED that certified copies of this Concurrent Resolution be transmitted to the Director of the Legislative Reference Bureau, the Director of Commerce and Consumer Affairs, and the Chairman of the Real Estate Commission.

Appendix B

1988 SESSION LAWS OF HAWAII

ACT 278

S.B. NO. 2501

A Bill for an Act Relating to the Real Estate Commission.

Be It Enacted by the Legislature of the State of Hawaii:

SECTION 1. The purpose of this Act is to appropriate funds for a temporary condominium specialist position in the real estate commission to respond to questions and problems associated with condominiums. The legislature finds that many of the recent concerns relating to condominiums result from a lack of a clear understanding of the condominium laws of this State, and that the condominium specialist position will help to clarify these laws. Additionally, this temporary position is also expected to help satisfy the need for many of the proposed legislative solutions, including the need for a condominium commission.

SECTION 2. The department of commerce and consumer affairs is authorized to establish and fill one temporary condominium specialist position exempt from the provisions of chapters 76 and 77 to assist consumers with information, advice, and referral on chapter 514A, Hawaii Revised Statutes, and chapter 16-107, Hawaii administrative rules, relating to horizontal property regimes.

The condominium specialist shall have administrative, professional, and analytical work experience which demonstrates an ability to plan and coordinate activities and deal effectively with others.

To provide sufficient time for the condominium specialist to carry out the duties described in this Act, it is the legislative intent that this temporary position remain in existence until June 30, 1990.

Twenty days prior to the convening of the 1991 regular session, the department of commerce and consumer affairs shall submit to the legislature a report: evaluating the effectiveness of the position in responding to condominium-related inquiries; identifying any major problem areas; and, if appropriate, recommending legislation to resolve these problems.

SECTION 3. There is appropriated out of the general revenues of the State of Hawaii the sum of \$30,000 or so much thereof as may be necessary for fiscal year 1988-1989, to hire a temporary condominium specialist to carry out the purposes of this Act. The sum appropriated shall be expended by the department of commerce and consumer affairs.

SECTION 4. This Act shall take effect on July 1, 1988.

(Approved June 13, 1988.)

Appendix C

TESTIMONY ON S.C.R. NO. 100

PRESENTED TO THE HOUSE COMMITTEES ON
CONSUMER PROTECTION AND COMMERCE, INTERGOVERNMENTAL RELATIONS,
JUDICIARY, AND LEGISLATIVE MANAGEMENT

Fourteenth Legislature
Regular Session of 1988

April 21, 1988

by Samuel B. K. Chang, Director
Office of the Legislative Reference Bureau

Honorable Chairs and Members of the Committees:

My name is Samuel B. K. Chang, Director of the Office of the Legislative Reference Bureau. Thank you for the opportunity to submit for your consideration the views of the Bureau on S.C.R. No. 100.

This concurrent resolution requests the Bureau to study various problems concerning the governance of condominiums, and to propose feasible means and methods of dealing with such issues more effectively. More specifically, the Bureau is asked to determine whether:

- (1) There are reasonable controls on the use and treatment of condominium association funds;
- (2) The current fiscal audits of association funds are adequate;
- (3) Owners receive adequate information regarding the use of maintenance fees;
- (4) The processes for selection of association boards of directors are fair and reasonable; and
- (5) There are adequate checks and restraints to prevent the abuse of power by board members, managing agents, or managers.

The concurrent resolution also requests that the condominium specialist, the creation of whose position in the department of commerce and consumer affairs is proposed in S.B. 2501, be a full participant in the study.

The Bureau believes that attempting such a study at this time is premature because there will not be enough time for the data necessary for this study to develop. Questions such as those which the concurrent resolution seeks to have answered--the adequacy of controls on funds, fiscal audits, information available on the use of fees, and so forth, are questions which are very much in the eyes of the beholder. As a practical matter, measures are adequate if the apartment owners of a particular condominium believe that they are. Measures which are

regarded as adequate by all of the members of one association may be regarded as grossly inadequate--or grossly excessive--by the members of another.

What would be by far the most practical means of attempting to come to some conclusions with regard to the problems raised in the concurrent resolution would be to approach the study from the standpoint of complaints raised by condominium residents--real problems raised by real people. For this reason, involvement on the part of the proposed condominium specialist is critical. As the person fielding questions and attempting to solve the problems raised by complainants, the condominium specialist will be able to see patterns developing in terms of the specific areas where the greatest number of problems cluster--the specific types of problems, and the specific types of abuses.

The condominium specialist, the pivotal player in this study, is not likely to be available immediately after the end of the legislative session. Assuming the authorizing legislation is enacted, the specialist may not be hired until July 1, or even later. More importantly, given the usual time needed for the public to become adequately informed of the existence of a new government program, persons having complaints are not likely to know about the availability of the condominium specialist until even later.

As a practical matter, any Bureau researcher working on a study will normally have to begin the report writing stage by the early part of October in order for the study to be distributed before the convening of the legislative session. This would effectively limit the range of data gathering to the period between the hiring of the condominium specialist and early October, a period of 3 months, or even less. There are dangers inherent in basing conclusions on too narrow a range of data. An erroneous impression could be given of widespread problems--or the lack thereof--if the small amount of data received is unrepresentative.

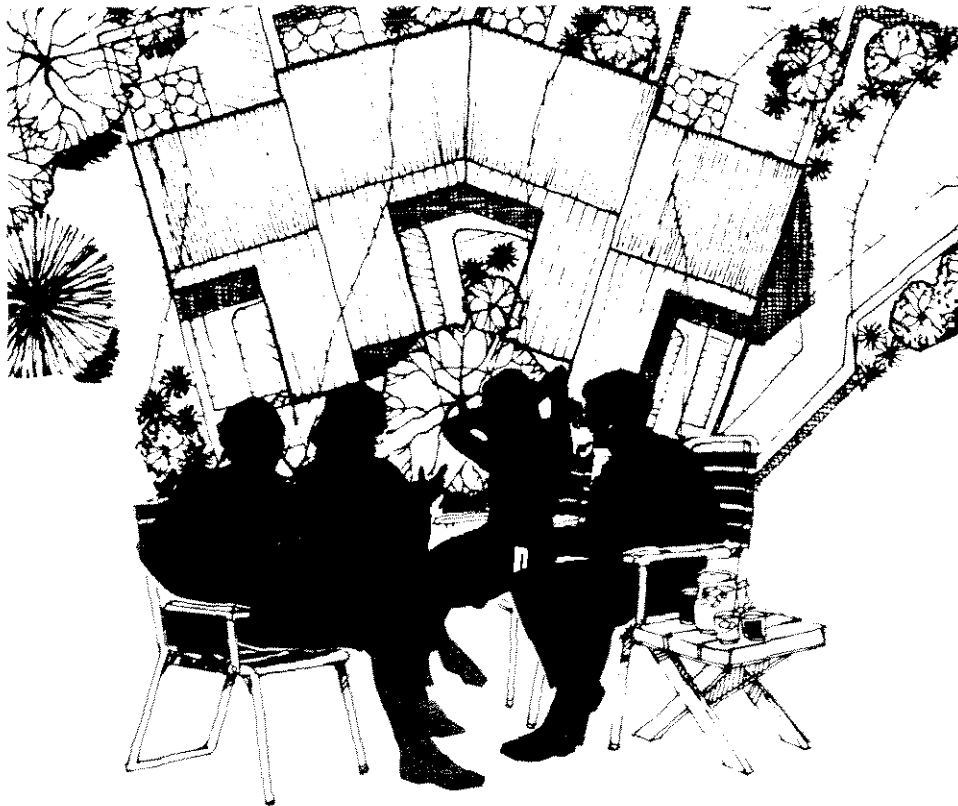
Apart from the foregoing observations, the Bureau has serious misgivings as to whether our researchers, if left to their own devices without the assistance of the condominium specialist or someone in the department of commerce and consumer affairs with overseeing responsibilities over condominiums, will be given access to information from condominium associations as to how they use and treat association funds, what their fiscal audits cover, how maintenance fees are accounted for, and what the process of selecting boards of directors are.

However, if the Committees believe it imperative that some type of study be conducted, the Bureau respectfully recommends that the study be submitted prior to the convening of the Regular Session of 1990, if not later.

Thank you for the opportunity to express the views of the Bureau on S.C.R. No. 100.

The Condominium Buyers Handbook

down-to-earth answers to your questions
about the condominium concept in Michigan



Corporation and Securities Bureau/Michigan Department of Commerce



Do You Know . . .

- *Your rights and responsibilities as a co-owner?*
- The developer's background and financial references?
- What's planned for future development in the project?
- The developer's rental policy?
- When the recreation facilities will be completed?
- Who will control the recreation facilities?
- What's included as standard equipment in your unit?
- What's under warranty?
- What costs are included in the monthly assessment?
- When the co-owners will be permitted to vote for directors of the condominium's Association?
- How condominium living differs from other types of residential living?
- The difference between a Preliminary Reservation Agreement and a Purchase Agreement?

You Should Know The Answers To These Questions Before Buying A Condominium

Introduction

The first edition of this booklet was published by the Corporation and Securities Bureau, Michigan Department of Commerce in 1975. Since then, there have been changes in both the condominium industry and the law governing the development of condominiums. On March 14, 1978, a new condominium act, designed in part to provide condominium purchasers more protection than the previous Horizontal Real Property Act of 1963, was signed into law and the handbook was revised to reflect the changes.

On January 17, 1983, an amendment to the Condominium Act (1978, PA 59) became effective. This amendment, P.A. 538 of 1982, changed the law so that condominium developers will no longer file applications with the Department of Commerce for approval of their project before marketing units or establishing the project by recording the condominium documents with the county register of deeds. This latest edition updates the information to include 1982 PA 538 and subsequent amendments.

While the condominium concept has expanded in recent years to include commercial and industrial projects, the information presented in this booklet is directed primarily toward the prospective buyer of a residential condominium. Read this booklet and all documents relating to the particular project carefully so you may make an informed decision.

Keep in mind that most developers have well-earned reputations for honesty, integrity and competence. If a negative factor is encountered in a particular project, it does not necessarily mean the project is unsound or that the developer is unscrupulous. It may be due to an oversight or lack of understanding which can be easily corrected.

In all cases, we recommend that you seek professional assistance from a lawyer or other business advisor before buying a condominium.

What Is a Condominium

You've heard about condominiums, read newspaper ads, or perhaps have a friend or relative who is living in one. Now you are considering the purchase of a condominium unit for yourself.

What, actually, is a condominium?

The word *condominium* comes from a Latin word meaning common ownership or control. Ordinarily it means individual ownership of all the space inside the inner walls of an apartment or house and common ownership of the structures and land. This division between exclusive and common ownership exists regardless of the form or design of the project. The project may take the form of a high-rise, duplex, townhouse, or single family dwelling. In other forms of condominium projects such as mobile homes, campground, or marina, the exclusive ownership may be merely a cube of airspace within which a mobile home, recreational vehicle, or boat is parked or anchored. The common ownership would be the land and improvements such as concrete pads and piers and the utility systems.

The inner space, which you own, is yours to decorate, to maintain, to live in. Usually, everything else in the condominium development—the exterior walls, the land, the common hallways, the recreation facilities—is the common property of everyone who owns a unit and is termed *common elements*.

Limited or General Common Elements

Some of this commonly-owned property, such as your patio or balcony or carport space, is called *limited common elements* and is restricted to use by your family only. In the case of stairways or laundry facilities it may be limited to other families who live in your building, but it remains the common property of all the co-owners in the development. The rest of the common elements—roads, green areas, recreation facilities—are termed *general common elements* and are available for use by everyone in the development. You must read your legal documents carefully to understand which parts of your condominium are designated as limited, or general, common elements.

The co-owners of a condominium are legally organized into an association, which is responsible for governing and maintaining the common elements of the condominium. Each co-owner pays a monthly fee or assessment for these services.

Condo Advantages

Condominiums account for an increasing share of the housing market. There are several reasons for this:

- Condominiums, like single-family homes, offer owners certain tax deductions, appreciate in equity value and (unlike rentals) offer assurance of long-term occupancy.
- Condominiums often are more convenient to shopping and business facilities due to land use patterns, and demand less individual maintenance than single-family homes.
- Condominium projects may contain more recreational facilities (such as swimming pools and tennis courts) than an individual homeowner could reasonably afford.
- Condominiums are an economical and environmentally sound use of land compared to a subdivision containing the same number of living units.

How They Began

Condominiums are not a new concept in housing. The Romans used them and they were popular in the walled cities of the Middle Ages in what is now Western Europe. In the first half of the 20th century other European countries enacted statutes permitting condominiums.

A few condominiums existed in the United States as early as 1947, but they were not legally established in this country until 1961.

The concept of condominium housing was first incorporated into Michigan law with the passage of the Horizontal Real Property Act in 1963. Fifteen years later this law proved inadequate to meet the needs of the fast-growing condominium industry and in 1978, a new Michigan condominium law was enacted, PA 59 of 1978. This law, administered by the Corporation and Securities Bureau of the Michigan Department of Commerce, is important to buyers and developers of condominiums in Michigan because it provides safeguards for both parties and outlines the rights and responsibilities of each.

For condominium purchasers it establishes the legal basis for two relationships: (1) between the buyer and the developer of the condominium, and (2) between the owner of a condominium unit and the association of co-owners.

The Buyer and the Developer

Section 21 of the Michigan Condominium Act provides in part that: "A condominium unit located within this state may not be offered for its initial sale in this state unless the offering is made in accordance with this Act or the offering is exempt by rule of the administrator."

P.A. 538 of 1982, effective January 17, 1983, changed the law, in that the developer is no longer required to have a Permit To Take Reservations or Permit To Sell prior to offering condominium units to the public. In addition, developers and associations will no longer be required to obtain approval of amendments to project documents, even though the documents may indicate approval is required.

Under the amended Condominium Act, the developer will be required, unless exempt, to meet a more stringent escrow requirement. The developer is required to create a series of escrow accounts to assure completion of the construction of a phase of a project once sales have started. A licensed architect or engineer would determine if the project was substantially complete or would set the amount of escrow necessary to ensure the developer's ability to complete those portions of the project that must be built.

Advertising and Sales

There are some prohibitions on the content of the developer's advertising, including newspaper ads, radio and television announcements, brochures, material in the sales office, sales presentations, and the housing models themselves.

The developer or salesman cannot advertise or tell you orally

- that your unit will automatically increase in value if you wish to sell in the future;
- that you must act quickly to purchase a unit because of limited availability or because the price will increase, unless this is actually the case;
- that you will receive a discount or savings, or that you will receive "free" goods or services for purchasing a unit, unless this is actually the case.

In a model of the unit, the developer must tell you which items are not standard equipment, such as special flooring, carpeting, ceiling beams, moldings, light fixtures, patios, fences, or other features.

Persons selling condominiums in Michigan are also subject to the rules of the Michigan Department of Licensing and Regulation and are usually required to hold a real estate broker's or salesperson's license.

Preliminary Reservation Agreements and Purchase Agreements

Once you've made up your mind which condominium you want, you will be asked to sign one of the following agreements:

Preliminary Reservation Agreement This agreement will never become a binding sales document. It is not binding on either you or the developer. It simply gives a prospective purchaser the first opportunity to buy a specific unit once the developer has established the project. Many developers use this method to test the market for their project. Since the Preliminary Reservation Agreement can never become a binding sales

document, you must then enter into a Purchase Agreement with the developer, if you decide to buy. However, should you cancel, the developer must refund your money within three business days.

Purchase Agreement This agreement may be the first agreement you sign with the developer or it may follow the use of a Preliminary Reservation Agreement. In either case, this agreement is not binding until nine business days after the developer has delivered the condominium documents to you, as the prospective purchaser. The condominium documents that must be delivered would include:

- the recorded master deed, which would include as attachments the condominium bylaws and condominium subdivision plans
- a copy of the purchase and escrow agreements

—Condominium Buyers Handbook

—Disclosure Statement

—If the project is a conversion, the developer must disclose known information regarding the condition of the building, any building code or other regulation violations, and the year(s) of construction of the building

If you decide not to buy during the nine business day "cooling off" period, you may still request and receive your deposit in full, within three business days of cancellation notification.

If you decide to withdraw after the cooling off period, your deposit may be forfeited. A provision in a purchase agreement for liquidated damages in case of default is limited by the Condominium Act to a reasonable percentage of the purchase price of the condominium unit. The provision does not prevent the developer from recovering actual damages.

If you want to close the transaction immediately without waiting for the nine business day "cooling off" period, you can do so by signing a written waiver. The sale of the unit could then be concluded when the certificate of occupancy is issued to the developer, and other requirements in the purchase agreement are completed.

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The agreements and other documents used for the offer and sale of a condominium are different from those used for the offer and sale of conventional real estate. It is important that you seek professional advice or assistance when reviewing the package of documents received before signing a preliminary reservation agreement or purchase agreement. You may also find it necessary to modify an agreement or contract to meet your particular needs or circumstances. You may be subject to a binding purchase agreement before construction begins or is completed.

The Master Deed, Condominium Bylaws and the Disclosure Statement

The condominium documents mentioned in the preceding section—the master deed, condominium bylaws and disclosure statement—contain important information about the project in which you're interested.

The master deed and condominium bylaws, along with the condominium subdivision plans, are the basic documents establishing and describing your condominium and the future operation of the project. These documents must be recorded with the Register of Deeds in the county where the condominium is located.

The disclosure statement contains a summary of important information about the developer's previous experience.

What Percent of the Project Do You Own?

The master deed will designate the percentage of ownership each condominium unit has in the total project. This percentage of value will determine your obligation for payment of assessments and may determine your voting percentage at association meetings. In some instances, the master deed may state that all votes and obligations to pay assessments will be equal. The percentage of value in that case only describes what your percentage of ownership in the total property will be. Read your master deed carefully to determine which method is used. This can be a controversial matter if not fully understood from the beginning.

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Read the Fine Print!

Read all these documents carefully. You should be aware of restrictions or covenants which govern the use of your

condominium and the surrounding land. Check the master deed

and your preliminary reservation agreement or purchase agreement

to learn what, if anything, the developer reserves the right to

change or modify in the future. The most common reservation is

the right to expand or contract the project. Make sure you

understand just how the developer plans to do this. Many

developers build a small number of units at a time, holding

sections of nearby land for other phases or future parts of the

condominium. The right to do this is reserved in the master deed. It

is important to know what will be built in the vicinity of your

condominium.

Other usual reservations are the right to correct survey errors,

the right to make changes in the documents that do not materially

diminish the rights of the co-owners or mortgagees, the right to

assign specific garage or parking space locations at a later date

and the right to rent units that are not sold.

You should also inquire about any unusual conditions that might affect the project. If the roads are private, for example, how much will it cost for maintenance? Is there a private water or sewage system? Are there any easements other than public utility easements which might affect the condominium project or your unit?

If your project contains recreational facilities, find out what the

developer's financial obligations are for these facilities and the

responsibilities of the co-owners for the financing and management

of the facilities. Find out if third parties will be using the facilities

and when the facilities will be turned over to the association.

Warranties

Most buyers also are interested in the kind of warranty that comes with their condominium. The answer usually is found in the purchase agreement. The developer normally warrants the project against building defects in materials or workmanship for one year. Be sure to find out when the warranty begins and whether it covers building structures, recreational facilities, roads, sidewalks and

Conversions—How Good?

shrubbery. Remember that warranties generally cover only new construction. There may be no warranty if you are buying a unit in a conversion project.

Many conversion projects are offered "as is" to the buyer.

Although local authorities may inspect the building's heating,

plumbing, and electrical systems, roofing and structure, the

developer will not guarantee the project if it is offered "as is." You

may want to personally inspect the building for these items.

It is important to be aware when local authorities inspect the

building it is to be sure it conforms to construction codes in effect

at the time the structure was originally erected or remodeled. This

may or may not be up to the current code for new construction

depending on the age of the building. Any extensive remodeling

done at the time of conversion, however, would have to meet

current construction standards.

Pitfalls and Safeguards

Since a condominium is a large investment of your money, ranging from about \$20,000 to more than \$150,000, it is important that you be fully informed before you buy. And, beyond being fully informed about the condominium itself, the single most important step you can take before you buy is to *know your developer* before entering into a binding agreement. The two things you should be looking for in a developer are competence and integrity. Ask about the developer's previous experience. The disclosure statement will list the names and addresses of projects with which the developer has been associated. Visit those projects and talk to the people who live in them. If people are already living in the condominium project you are considering, discuss the project and the developer with them.

The "pitfalls" mentioned here represent problems a person could conceivably encounter in the purchase of a condominium. The "safeguards" describe steps one can take to avoid them.

1. Pitfall—Yielding to a high pressure sales pitch by signing contracts or agreements which you do not fully understand.
Safeguard—Do not take a chance on losing your investment. Carefully review all documents and seek professional assistance.

2. Pitfall—Falling for a sales pitch which emphasizes the advantages of equity buildup and maintenance-free living, but does not point out the responsibilities of owning a condominium.
Safeguard—Do not be glibble! get all the facts and weigh them. Owning a condominium is not the same as renting an apartment where you can rely on the landlord to maintain your building. You and other co-owners are your own landlords and will be collectively responsible for arranging for the upkeep of your project.

3. Pitfall—Entering into a binding purchase agreement which does not depend on your being able to obtain a mortgage commitment or acceptable financing.

Safeguard—Do not sign a binding purchase agreement until you have arranged your financing or unless the agreement specifies that it is dependent upon your ability to obtain a mortgage commitment for the condominium you wish to buy. Otherwise you could lose your deposit as liquidated damages if you are unable to obtain financing.

4. Pitfall—Assuming that you will have to pay only the purchase price before moving into your condominium.
Safeguard—Determine in advance the total amount due at the time you complete the deal. In addition to the purchase price, you may have to pay settlement or closing costs. Some developers also charge advance assessments which are due at closing. Find out if your developer does this and determine how the advance assessments will be used.

5. Pitfall—Relying on verbal promises regarding such matters as when your unit will be ready for occupancy, warranties, stability of monthly assessments and items the developer will install.
Safeguard—Do not rely on verbal promises. If you are promised something, insist that it be put in writing and signed by the person who made the promise. If you have been given a date when your condominium will be ready, find out if the date has been given on a firm commitment basis (that it will be ready on that date no matter what), or if the date is subject to change under certain conditions (strikes, material shortages or other reasons). If you are shown a model unit, find out what items will be included in your unit and be sure they are written into the purchase agreement.

6. Pitfall—Assuming that you will not be able to hear your neighbor because your condominium has been "sound conditioned."
Safeguard—Sound conditioning is not the same as sound proofing. Sound conditioning merely means that the developer has taken some steps to reduce the transmission of sound between units—not to eliminate it.

7. Pitfall—Deciding to purchase a unit in a "conversion" condominium project because "they don't make 'em like they used to and the price is right."

Safeguard—Purchase price savings can be quickly used up through high assessments. When buying a condominium in a structure which has been converted from an existing building, keep in mind that you will not only become the owner of a unit, but also a joint owner of the furnace, roof, pipes, wires and other common elements. Ask for a copy of an architect or engineer's report on the condition of all building components and their expected useful life. Ask to see copies of the building maintenance records for preceding years. Find out what improvements the developer has made. Do not be misled by a fresh coat of paint and new carpeting. Find out what, if any, warranties remain.

The Buyer and the Association

When you take title to your unit, you automatically become a co-owner and a voting member of the co-owners' association formed to administer the affairs of the condominium. The association is usually a non-profit corporation. The value of each vote is normally determined by the percentage of value given to each living unit and is stated in the master deed. However, voting and the obligation to pay assessments may not necessarily be equal, and this fact also must be stated in the master deed and condominium bylaws.

Who's in Charge?

The association is governed by a board of directors appointed by the developer until the first annual meeting. This initial meeting of *the co-owners to elect members to the board of directors may take place one year or more after the master deed is recorded.* The provisions for holding the annual meeting and designating the voting procedures are included in the condominium bylaws, along with other information about the operation of the association. The condominium bylaws are attached to and incorporated by reference in the master deed you receive when you buy a condominium. The bylaws should be read carefully as they may contain complete provisions outlining your rights as an owner as well as the scope of activities permitted co-owners of the project during the transition.

Before the first annual meeting of the association, the developer may have the ability to amend the condominium bylaws so long as the amendment does not materially affect the rights of the co-owners. If units are still being sold after the first association meeting, the developer votes and pays assessments as any other co-owner.

Associations Have Bylaws, Too!

The association also operates under its own bylaws, in addition to the condominium bylaws. Association bylaws provide for the operation of the association as a non-profit corporation including details regarding officers, directors, meetings, order of business, and so forth.

Responsibilities and Rights

The Association

The association usually is responsible for maintenance of the outside of the condominium units, such as hallways, lobby, building exterior, lawn care, snow removal, trash pick-up, street maintenance (if the roads are private), and operation of the common elements, including the recreation facilities, heating plant, water or electric systems. These jobs are done through a management firm or manager hired by the association, by employees hired directly by the association, or, in some cases, by co-owners themselves.

The association sets fees for the maintenance of those common elements which fall under its responsibility as stated in the master deed or other condominium documents and may increase the charges. Special assessments may be made by the board of directors to cover capital improvements, but generally any substantial increase in the monthly assessment must first be approved by a vote of the co-owners. The condominium bylaws often set the dollar limit on what may be approved by the board of directors without a vote of the co-owners.

The condominium bylaws also provide methods for settling disputes concerning interpretation or application of the master deed, bylaws, management agreement or between co-owners, between co-owners and the association, or between the association and the management firm.

The Co-owners

While the association is responsible for maintaining the common elements of the condominium, you are responsible for the maintenance and upkeep of your unit interior.

There may be restrictions on your use of your unit that can be enforced by the association. They include such things as: restrictions on pets; selling or renting your unit to someone of your choice; willing it to another person. Check for these in the condominium bylaws.

The association also sets rules for use of the recreational facilities and other common elements. It may require approval of repairs or structural modifications you wish to make in your unit. If

you mortgage your unit, you must notify the association of the name of the lender who is holding the mortgage, and the association may inform the mortgage holder of unpaid assessments due from you for your unit. Late charges and other penalties for non-payment of assessments are also common provisions found in the condominium bylaws.

All condominium associations created and operating under the Condominium Act must make provisions for a reserve fund to be used for major repairs and replacement of common elements. Ultimately, the co-owners must determine whether the amount kept in the reserve account is adequate for their project.

and More Questions . . .

Some additional questions often asked by prospective buyers are:

- What does the monthly assessment include?
- If I don't use all the facilities, why do I have to pay for them?
- What happens regarding unpaid monthly assessments if a co-owner defaults?

The monthly assessment varies from one development to another, but generally includes repairs and maintenance costs, insurance, reserve funds, management costs and upkeep for recreation facilities. You should receive a disclosure statement itemizing the budget at the time you are given the master deed.

If the project is a conversion—that is, converted from rental housing to condominium ownership—the developer should report actual past costs of maintenance and repairs and taxes from previous years and how they compare with the proposed budget. Remember, however, that the project may be assessed differently for tax purposes when it is converted, which could mean a tax increase.

The monthly assessment is considered as a lien on the condominium and you cannot exempt yourself from paying it, whether you use all the facilities provided or not.

If a co-owner loses a condominium unit through foreclosure to a lender, the lender is not liable for assessments charged to the unit and still owing. The unpaid assessments will be allocated among all of the units, including the foreclosed unit.

What to Do If You Have a Complaint

A reputable developer is interested in dealing with you fairly if you have problems with your condominium. It is in the developer's best interest to create satisfied owners, and, therefore, the majority of your questions and complaints usually can be handled by direct communication and negotiation between the two of you.

Ask your developer for the name, address and telephone number of the person within its organization to contact when you have a complaint.

If your project was established after the Condominium Act amendments took effect in 1983, your purchase agreement should contain wording that explains your right to take any claims against the developer, which involve \$2,500.00 or less, before the American Arbitration Association.

There are procedures to follow if you are not satisfied with the construction of the development, or you think you have been misinformed by a condominium sales representative, or you are in disagreement with the practices of the co-owners' association, or if some other problem does arise.

If your difficulty is with the developer, first contact the developer by letter. If no response is received within 15 days after the developer receives a certified, return receipt requested letter, contact:

1. For Construction Defects:

- A. Your local building inspector
- B. Michigan Department of Licensing and Regulation,
Bureau of Realty and Environmental Services, Complaint
Analysis Division, P.O. Box 30018, 808 Southland,
Lansing, Michigan 48909.
Telephone: (517) 374-9625

2. For Sales Misrepresentations:

- A. Corporation and Securities Bureau, Michigan Department
of Commerce, P.O. Box 30222, Lansing, Michigan 48909.
Telephone: (517) 373-8026
or
- B. Michigan Department of Licensing and Regulation,
Bureau of Realty and Environmental Services, Complaint
Analysis Division, P.O. Box 30018, 808 Southland,
Lansing, MI 48909
Telephone: (517) 374-9625

3. Actions Regarding Purchase Agreement or Master Deed:

Corporation and Securities Bureau,
Michigan Department of Commerce,
P.O. Box 30222, Lansing, Michigan 48909
Telephone: (517) 373-8026

If you have a complaint with the association at the time it is controlled by the co-owners or with other co-owners, check the condominium bylaws to find out what recourse you have. Neither the Corporation and Securities Bureau nor other state agencies generally have jurisdiction over complaints between these parties.

The Corporation and Securities Bureau requests that you submit a written complaint on forms which you may obtain from the Bureau. You should include copies of any documents that support your complaint when you forward it to the bureau for review.

When the bureau receives your complaint, it will contact you to get any other necessary information and then determine whether the bureau has jurisdiction. If so, contact is made with the developer to try to work out a solution that is satisfactory to everyone involved. If negotiation fails to settle the dispute, the bureau may consider other administrative remedies. If it does not have jurisdiction, the bureau may make a referral to another state agency.

If a developer, real estate broker or related party violates the Condominium Act, the Corporation and Securities Bureau may decide to impose certain sanctions or refer the matter to the attorney general or local prosecutor.

In addition, you may have civil remedies available. For instance, a developer who attempts to close on a unit without delivering the required documents is liable under Section 115 of the Act to the purchaser of the unit for damages.

The jurisdiction of certain agencies such as the Michigan Department of Licensing and Regulation may be limited to complaints filed within a specific period of time after construction or sale. For this reason it is important that you pursue any complaints quickly and be able to back up any claims.

At the end of this handbook is a section entitled "Available Remedies Under the Condominium Act." This is a reference to the portions of the Act that grant certain rights to the consumer in pursuing complaints.

Remember:

The best protection in buying a condominium is your own common sense. Follow these steps and you should enjoy condominium ownership:

1. **Know Your Developer.**
2. **Read and Know the Contents of Your Condominium Documents.**
3. **Get Sales Promises in Writing.**
4. **Don't Submit to High Pressure Sales Tactics.**
5. **Get the Answers to the Questions in This Book.**

What the Words Mean

Assessment (Operating)

Proportional share of the budgeted annual cost which is paid as a monthly charge to maintain the common areas and elements of a condominium and to maintain a sufficient reserve fund to assure financial stability.

Assessment (Special)

An assessment made for some special purpose or because of inadequate budgeting of operating expenses.

Association of Co-Owners

All of the co-owners acting as a group in accordance with the master deed and bylaws for the administration of the project. The co-owner can exercise voting rights in the association.

Condominium Bylaws

The operation of the property is governed by a set of bylaws which are recorded with the master deed. The bylaws impose certain duties and obligations on the co-owners and the association such as timing of meetings, record keeping, and determination and collection of assessments.

Association Bylaws

The association bylaws set forth the operating procedures for the association.

Common Interest

The percentage of undivided interest in the common elements apportioned to each unit as expressed in the master deed.

Co-Owner

A person who buys a unit in a condominium project becomes a co-owner. A co-owner owns a divided interest in the unit purchased, which may be a fee simple interest or a land contract vendee's interest, and has an undivided co-interest in all the common property in the condominium project.

Default

The failure to meet certain contractual obligations, such as monthly payments or maintenance of the property.

Easement

An easement in a condominium refers to the right of use under, across or over the land and improvements in the condominium, such as the sewer pipe or utility easement running beneath the surface of the land, the right to walk over a parking area or over the lobby area and stairways, and the right to have the utility lines running through the walls of a building.

Escrow Funds

Subscription deposits or downpayments required to be held unused, until the condominium project is recorded and titles are conveyed to each buyer.

Liability and Hazard Insurance (Association)

Insurance to protect against negligent actions of the co-owners and other common hazards. This policy differs from the homeowner's personal insurance on the unit and furnishings.

Lien

A claim recorded against a property as security for payment of a just debt.

Limited Common Element

Those common elements designated in the Master Deed and reserved for the use of a certain unit to the exclusion of other units, such as hallways on a given floor reserved for the use of the apartment owners on that floor, carports, patios, or balconies.

Master Deed

The basic document used in the creation of a condominium, describes the division of the project into units and common elements.

Mortgage Commitment

The written notice from the bank or other lender saying that it will advance the mortgage funds in a specified amount to enable one to buy the unit.

Reserve Funds (Replacement)

Funds which are set aside usually in escrow from monthly association assessments to replace common elements, such as roofs, at some future date.

Taxes
Local real estate taxes are levied on the individual units and not on the condominium association.

Undivided interest

In condominium law, the joint ownership of common areas in which the individual percentages are known but not applied to separate the areas physically. This situation is similar to the joint ownership of an automobile or home by husband and wife.

Available Remedies Under The Condominium Act

Section 145 of the Act provides that at a minimum, a purchaser would have the following remedies available to resolve a complaint:

1. The right to bring an action under Section 115 of the Act.
Section 115 provides a person or association of co-owners adversely affected by a violation of, or a failure to comply with, the Act, Rules promulgated under the Act, or any provision of an agreement or a Master Deed, may bring an action for relief in a court of competent jurisdiction. This section provides that the court may award costs to the prevailing party. The section also provides that under certain circumstances, the court may award damages to the purchaser because of the developer's actions.
A purchaser or association of co-owners considering this remedy should consult with their legal advisor.
2. The right to arbitration under Section 144 of the Act. Section 144 provides:

"(1) A contract to settle by arbitration may be executed by the developer and any claimant with respect to any claim against the developer that might be the subject of a civil action.

(2) At the exclusive option of the purchaser, co-owner, or person occupying a restricted unit under section 104b, a contract to settle by arbitration shall be executed by the developer with respect to any claim that might be the subject of a civil action against the developer, which claim involves an amount less than \$4,500.00 and arises out of or relates to a purchase agreement, condominium unit, or project.

(3) At the exclusive option of the association of co-owners, a contract to settle by arbitration shall be executed by the developer with respect to any claim that might be the subject of a civil action against the developer, which claim

arises out of or related to the common elements of a condominium project, if the amount of the claim is \$10,000.00 or less.

- (4) The period of limitations prescribed by law for the bringing of a civil action shall apply equally to the execution of a contract to settle by arbitration under this section.
- (5) All costs of arbitration under this section shall be allocated in the manner provided by the arbitration association.
- (6) A contract to settle by arbitration under this section shall specify that the arbitration association shall conduct the arbitration.
- (7) The method of appointment of the arbitrator or arbitrators shall be pursuant to reasonable rules of the arbitration association.
- (8) Arbitration under this act shall proceed according to sections 5001 to 5065 of Act No. 236 of the Public Acts of 1961, being sections 600.5001 to 600.5065 of the Michigan Compiled Laws, which may be supplemented by reasonable rules of the arbitration association.
- (9) An arbitration award shall be binding on the parties to the arbitration."

A purchaser or association of co-owners considering this remedy should consult with their legal advisor.

- 3. The right to lodge a complaint pursuant to Article 5 of the Occupational Code (Section 501 to 522 of 1980 P.A. 299).

A condominium developer may be required to be a licensed residential builder under the Occupational Code. Complaints concerning construction would be filed with the Department of Licensing and Regulation, Complaint Division, P.O. Box 30018, Lansing, Michigan 48909.

- 4. The right to initiate an investigation or bring an action under the Michigan Consumer Protection Act, 1976 P.A. 331.

This is an Act to prohibit certain methods, acts, and practices in trade or commerce; to prescribe certain powers and duties; to provide for certain remedies, damages, and penalties; to provide for the promulgation of rules; to provide for certain investigations; and to prescribe penalties.

Complaints may be filed with the Department of Attorney General, Consumer Protection Division, 525 West Ottawa, Lansing, Michigan 48913. Complaints may also be filed with the Prosecuting Attorney in the county in which the condominium project is located.

A purchaser or association of co-owners considering this remedy may wish to consult with their legal advisor.

- 5. The right to notify the appropriate enforcing agency of an alleged violation of the State Construction Code, other applicable building code, or construction regulations. The term "enforcing agency" is defined in the State Construction Code, 1972 P.A. 230, as the local building official.

Section 150 of the Act grants certain discretionary powers to the Bureau as specified at Sections 151 to 156 which shall be exercised only with respect to actions which materially endanger or have endangered the public interest or the interest of condominium co-owners, as enumerated at Section 154. Sections 151 to 156 state the following:

"Sec. 151. The administrator in its discretion may:

(a) Make private investigations within or without this state as it deems necessary to determine if a person violated or is about to violate this act or a rule promulgated or order issued under this act, and may publish information concerning the violation of this act or rule or order.

(b) Require a developer to file a written statement in response to complaints received by the administrator and forwarded to the developer. The statement shall set forth the facts and circumstances concerning the matter raised in the complaint. Failure to respond to a letter requiring information within 15 days after its receipt shall be ground for issuance of immediate order directing a response.

Sec. 152. (1) For the purpose of an investigation or proceeding under the act, the administrator or its authorized representative upon making application to the circuit court and showing of cause that a violation may occur or has occurred and obtaining order of said court, may administer oaths and affirmations, subpoena witnesses, compel their attendance, take evidence, and require the production of books, papers, correspondence, memoranda, agreements, or other documents or records which the administrator deems relevant or material to the inquiry.

(2) The administrator or any of its officers or employees shall not disclose to the public any investigative information which is filed with, or obtained by, the administrator and which is not made public under this act. This act shall not be construed to authorize the administrator or any of its officers or employees to disclose investigative information except among themselves or when necessary or appropriate in a proceeding or investigation under this act, or to federal, state, local, or foreign governmental agencies for their official use. This act shall not be construed to create or derogate a privilege which exists at common law or otherwise when documentary or other evidence is sought under subpoena directed to the administrator or any of its officers or employees.

Sec. 153. If the administrator has reason to believe that a person is in violation of this act, the administrator shall notify the person and the developer of the investigation and the possibility of administrative or civil action at least 10 days before commencement and the proceeding. Before commencement of administrative proceedings the administrator may issue a nonpublic statement of intent to commence proceedings to persons who are subjects of an investigation relating to possible violations of the act. The notice shall provide that the subjects of the investigation shall have opportunity to show why proceedings should not be commenced against them. If a response satisfactory to the administrator is received, then further proceedings under this act shall not be required.

Sec. 154. The administrator may issue an order to show cause why an order barring or suspending a person from condominium development, sales or management, should not issue if it finds that the order is in the public interest and that actions which materially endanger or have endangered the public interest or

the interest of condominium co-owners exist and said actions are enumerated and limited to the following:

(a) A disclosure statement, the master deed, or a related document filed with the administrator in connection with a condominium project is incomplete in any material respect or contains a statement which is false or misleading in the light of the circumstances under which it is made.

(b) This act, or a rule, order, or condition lawfully imposed under this act, has not been complied with or was violated, in connection with the offering by the person filing the document; the developer; a partner, officer, director, proprietor, or manager of the developer; or a person directly or indirectly controlling, or directly controlled by, the developer.

(c) The condominium project worked or tended to work a fraud, deception, or imposition, or would so operate, or the condominium project would create an unreasonable risk to prospective co-owners, as defined by rules promulgated by the administrator.

(d) The developer, a partner, officer, director, proprietor, or manager of the developer, or a person directly or indirectly controlling or directly controlled by the developer, or a person identified in a disclosure statement, was convicted of an offense under this act within the past 10 years, is the subject of an administrative order under this act, or has had a civil judgment entered against him or her as a result of a violation of this act or a rule or order promulgated pursuant to this act; and said judgment has not been satisfied and the administrator determines that the involvement of the person in the sale or development of the condominium project creates an unreasonable risk to prospective co-owners.

(e) The developer, a partner, officer, director, proprietor, or manager of the developer, or a person directly or indirectly controlling or directly controlled by the developer, or a person identified in a disclosure statement was:

- (i) Convicted of a violation.
- (ii) Had a civil judgment entered and has not satisfied said judgment as a result of a violation of a statute regulating

the offering of securities or franchises or licensing or regulating builders, real estate brokers, or real estate sales persons; or as a result of a violation of Act No. 286 of the Public Acts of 1972, as amended, being sections 565.801 to 565.835 of the Michigan Compiled Laws, or a rule promulgated or order issued thereunder.

(f) The developer's method of business, construction, development, or sales includes or would include activities which are illegal.

(g) The applicant failed to diligently seek or was denied appropriate zoning, building, public health, or environmental permits.

Sec. 155. (1) When the administrator has cause to believe that a person engaged in an act or practice constituting a violation of this act or a rule promulgated or order issued under this act, the administrator may issue a notice to show cause why a cease and desist order should not be issued.

(2) After 10 days' notice and opportunity for hearing the administrator may stop construction as to part or all of a condominium project when the continuous building would cause irreparable harm to co-owners of the condominium project.

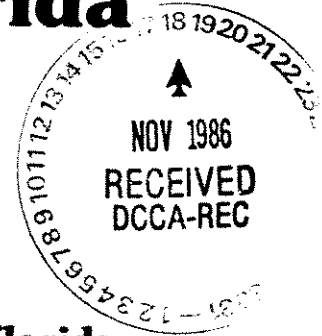
(3) If the administrator knows or has cause to believe that funds of individual co-owners or the association of co-owners were misapplied, converted by the developer, or that the developer understated maintenance or other fees for the purpose of enticing purchasers, or otherwise failed to meet financial obligations to the project, the administrator may require an appropriate escrow of funds from sales of condominium units pending resolution of the matter provided, however, that the escrow requirement under this section shall not impair any contractual rights of any first mortgagee to repayment of its loan from the proceeds of the sale of condominium units.

Sec. 156. A person may not represent that the fact that an application under this act is filed or a permit is granted constitutes a finding by the administrator that a document filed under this act is true, complete, or not misleading. A person may not represent that the administrator passed upon the merits or qualifications of, or recommended or gave approval to, a person, developer, transaction, or condominium project."

This handbook is published as a general guide for people who are considering buying a condominium. It is not intended as a substitute for the Michigan Condominium Act (1978 P.A. 59), or for the rules of the Corporation and Securities Bureau that pertain to condominiums, or for the specific condominium documents of any development.

DBR 336

State of Florida
Department of Business Regulation
Division of Florida Land Sales
Condominiums & Mobile Homes
The Johns Building
725 S. Bronough Street
Tallahassee, Florida 32301-1927



State of Florida
Department of Business Regulation
Division of Florida Land Sales,
Condominiums & Mobile Homes
Bureau of Condominiums

The Johns Building
725 S. Bronough Street
Tallahassee, Florida 32301-1927

Introduction

Condominium living offers many benefits which appeal to increasing numbers of individuals and families. In the last decade, the number of condominium units in Florida increased to over 100,000 units. Demographic studies indicate that the trend of rapid growth in condominium living will continue.

Many factors account for this rapid growth. Tenants avoid ever-increasing rents and gain tax advantages and investment benefits through ownership. Homeowners find condominium ownership can be an economical solution to constantly rising land values, building costs, and maintenance expenses. Condominiums also provide an opportunity to enjoy commonly owned recreational and other facilities that might otherwise be unaffordable.

Condominium ownership is very old in concept, yet relatively new in the United States. Because of its newness, purchasers and owners are often not familiar with the complex and difficult-to-understand legal requirements. This booklet is intended to acquaint unit owners and prospective buyers with the concept of condominium ownership. The first part describes condominium ownership and operation and focuses on the individual's role in the condominium. The second part highlights unit owner protections under Florida law, while part three outlines the functions of the Division of Florida Land Sales, Condominiums and Mobile Homes.

Part I: Condominium Ownership and Operation The Condominium Concept

A condominium is a form of property ownership in which an individual owns a unit exclusively and owns common elements jointly with all other unit owners in the condominium. Like people, condominiums come in many sizes, shapes and forms. Apartments, townhouses and resort-like motels are often converted to condominium ownership. Other examples include mobile home and trailer lots, camper sites, docking facilities, stables, recreation facilities and even a former luxury liner. Any real property may become a condominium.

Common elements are those portions of the condominium property which are not included in the units. All unit owners share common element ownership in an

undivided manner. Roofs, exterior walls, the condominium grounds and recreation facilities are examples of items which are usually common elements. Common elements are legally attached to each unit and are transferred with the unit when it is sold.

The development and creation of a condominium is a lengthy process. In addition to business and construction considerations, a developer must also draft the condominium documents which include, but is not necessarily limited to, a declaration of condominium, articles of incorporation of the association, and bylaws of the association. These documents, which must comply with the Florida Condominium Act, contain restrictions on the use of the property as well as the mechanism and procedures under which unit owners will eventually operate the condominium. Thus, the developer makes many important decisions relating to the future operation of the condominium before any units are sold.

An important part of the development process is the filing of the condominium documents with the Division of Florida Land Sales, Condominiums and Mobile Homes. The activities and functions of this agency are described in Part III.

Operating a Condominium

Association

The operation of a condominium is carried out through its association, usually a not-for-profit corporation made up of all persons owning units in the condominium. The association manages and operates the condominium community, provides common services, and maintains common elements. Each purchaser, by accepting deed to his or her unit, automatically becomes an association member, bound by its rules and regulations.

Condominiums are often compared to municipalities. The condominium association has powers and responsibilities which are similar to those of local governments. It must collect assessments to pay for the expenses of operating the condominium. It must also enforce the rules and regulations.

Associations, by amending their documents to include requirements relating to the use, maintenance

and appearance of units and the common elements, in effect, perform legislative-type functions.

Board of Directors

The association has a board of directors elected by the unit owners to represent them in managing the condominium. The board administers the affairs of the association, sets policy, assures proper property maintenance and appoints committees to manage various affairs of the condominium. Often such committees include: Rules Committee, Financial Committee, Election Committee, and Social Events Committee. Effective committees are important to a well-run condominium association because they help the board carry out its powers and duties.

The board of directors has a fiduciary responsibility to act with the highest degree of good faith and to place the interests of the unit owner above the personal interests of the directors.

Although the board of directors is essentially the decision-making body for the condominium, the association's effectiveness rests primarily with its membership—the unit owners. For an association to be successful, unit owners must take an active part by attending condominium meetings, voting, serving on committees and assisting in other affairs of the association whenever possible. These things are essential to an association's survival. Apathy on the part of unit owners can render an association ineffective.

So that each unit owner may be informed and have a voice in the operation of the condominium, Florida law provides for annual meetings, meeting notices, open board meetings, elections, recall of directors, voting, and personal access to condominium books and records.

Management

The day-to-day management of the condominium property is the most important association function. While the documents provide an outline for orderly operation, real-life operation can be a vastly different experience. It is the membership's duty to determine the association's needs, the membership's desire for personal involvement, and the association's financial capabilities. There are many management options available to the association, ranging from owner management to professional management. Only through a process of evaluation can an association determine the type of management best suited to its unique needs, desires, and capabilities.

Restrictions and Responsibilities of Unit Owners

Condominium ownership has been proclaimed as a way to combine all the advantages of renting and buying into one package labeled "carefree living." Although buying a condominium unit does offer many advantages, there are many restrictions and responsibilities which accompany ownership.

Restrictions

Restrictions on the use of both the individual unit and the common elements help to preserve the best interests of all unit owners. It is usual to have limitations on the use, occupancy, and transfer of the condominium unit. For example, there may be restrictions on types of window coverings, pets, children, unit rental, and the number of unit occupants.

Just as the use of the unit is restricted, so is the use of the common elements. While all unit owners have the right to use the common elements, they must use them in the manner provided in the condominium documents and in the rules and regulations adopted by the Board of Directors of the association. Frequent restrictions on the use of the common elements include limitations on parking and types of vehicles allowed on the premises, limitations on modifications to the condominium exterior, and restrictions on the use of recreational and other common facilities.

Since each set of documents is different, the only way to determine specific restrictions pertaining to a particular condominium is to review the documents of that condominium. Restrictions are subject to change at any time the unit owners properly amend the documents to provide for such a change.

In addition to the use restrictions in the condominium documents, the Condominium Act gives the Board of Directors the authority to adopt reasonable rules and regulations concerning the use of the common elements, common areas and the recreational facilities. Since rules adopted by the Board will also determine how the common elements are to be used, a review of these restrictions will also be necessary.

Financial Responsibilities of the Unit Owner

The cost of operating and maintaining the condominium is funded through budgeting and assessing procedures carried out by the association. Unit owners

are assessed according to the proportions or percentages as set forth in the declaration of condominium. In a residential condominium, unit owners' shares of common expenses shall be in the same proportions as their ownership interest in the common elements. Unit owners must pay the assessments; they cannot be avoided simply by not utilizing various common facilities.

Assessments to unit owners vary depending upon the amenities and level of services being offered by a particular condominium. Purchasers who buy from a developer are entitled to receive an estimated operating budget showing the expected costs of operating the condominium. The budget is only an estimate and may not represent actual costs. Purchasers should expect an increase in the budget as inflation and wear and tear of furnishings and equipment take their toll. Unit owners may also expect to face special assessments when there is either not enough money in the budget for the expenditure, or the expenditure was not anticipated and therefore not included in the budget.

Items typically found in condominium budgets include administrative fees of the association, management fees, rent for recreational facilities, insurance premiums, reserves for capital expenditures and deferred maintenance, garbage collection and utilities for common areas.

In addition, the unit owner should expect to be individually responsible for such items as real estate taxes, cost of private telephone, personal insurance premiums covering the contents and interior of the unit, maintenance of the interior of the condominium unit, privately contracted janitorial or maid service and utility costs billed directly to the unit owner.

Other Responsibilities

The rules, regulations, levels of services, budget—in fact, all aspects of operating the condominium—are determined by unit owners through their association. Once the developer has sold most of the units, it becomes the responsibility of the unit owners to see that the affairs of the condominium are efficiently carried out.

Part II: Florida Condominium Law: Protections for Unit

In addition to numerous protections granted buyers, the Condominium Act contains several provisions protecting the rights of unit owners. Many of these are in keeping with Florida's Government-in-the-Sunshine philosophy and insure that unit owners have the opportunity to be informed regarding the affairs of their condominium. Others are intended to prevent problems and provide remedies for existing problems. The following are some of these:

Condominium Meetings

Unit owners are entitled to:

- an annual association meeting.
- special unit owner meetings.
- notices of association and board of directors meetings.
- open board of directors meetings.
- a copy of the proposed annual budget and notice of the budget meeting.

Voting and Elections

Unit owners:

- may vote by proxy.
- may be nominated for the board of directors from the floor.
- may remove directors from office with or without cause by majority vote.

Assessments

Unit owners' shares in the common expenses are payable at least quarterly.

Budget increases requiring assessments in excess of 115% of the prior year may entitle unit owners to call a special meeting to consider and enact a budget.

Association Books and Records

Unit owners are entitled:

- to review the minutes of all association meetings, which must be kept for at least seven years.
- to review all books and records of the association, which must be kept in the county where the condominium is located.

- to receive a complete financial report of the receipts and expenditures of the association, on an annual basis.
- to obtain copies of the official records at the reasonable expense, if any, of the unit owner.

Miscellaneous

Newly constructed condominiums carry implied warranties of fitness and merchantability.

Unit owners may void certain contracts made by the developer in the name of the association.

Unit owners may peaceably assemble on the condominium property.

Part III: Division of Florida Land Sales, Condominiums & Mobile Homes

The Division of Florida Land Sales, Condominiums and Mobile Homes is charged with the responsibility of enforcing the provisions of the Condominium Act, Chapter 718, Florida Statutes, relating to the development, construction, sale, lease, ownership, operation and management of residential condominiums. The Division, which is one of five divisions in the Department of Business Regulation, is involved in a number of activities affecting all segments of the condominium community.

The following sections describe some of these activities.

Examining Documents

Prior to offering units for sale, condominium developers must file with the Division one copy of each document required to be provided to prospective buyers. The filed documents include such items as the declaration of condominium, articles of incorporation, bylaws, rules and regulations that a unit owner must obey, and a budget estimating the future operating costs of the condominium. These items are examined to determine if they comply with the provisions of the Condominium Act. The Division does not, however, judge the merit of an offering nor does it assure complete compliance by the developer.

Legislation

The Division provides technical input to legislators regarding condominium problems in the form of data collection and interpretation, proposed legislation, and appearances at legislative committee hearings. In addition, the Division adopts rules to interpret and implement the Condominium Act.

Consumer Assistance

Inquiries regarding condominium matters are handled by Division staff, who analyze questions and respond in a clear and concise manner. Written materials, such as this brochure, are prepared to answer many of the questions more frequently asked by unit owners. Statewide workshops and seminars covering a variety of topics are held on a regular basis in order to provide information to the condominium community as well as keeping the Division in touch with the needs of unit owners. If you need information concerning the written materials or seminars, contact the Tallahassee Office.

Investigating Complaints

Anyone who believes that there has been a violation of the Condominium Act may file a complaint with the Division. Complaint forms with instructions are available from any Division office.

The Division attempts to informally resolve violations of the Condominium Act without legal action. In most cases, violators quickly comply with the Act. When an amicable settlement is not possible, the Division may use its enforcement powers to assure compliance.

Resolving Internal Disputes By Arbitration

The Condominium Act was amended in 1982, adding section 718.1255, Florida Statutes, "to provide voluntary binding arbitration of internal disputes arising from the operation of the condominium among unit owners, associations, their agents and assigns."

Arbitration is simply a method of solving disputes by submitting them to an impartial person who has the power to make a final determination concerning the issues in controversy. The Condominium Act contains provisions for arbitration in section 718.112(2)(k), Florida Statutes, when a vote for recall, or an agreement in writing for recall, is disputed.

The condominium arbitration process is particularly suited to disputes involving maintenance and repair of

the common elements, irregularities in meeting and voting, disputes involving condominium documents, adoption and enforcement of internal rules and regulations, association access to individual units and disputes arising out of the rental of units, just to name a few examples.

The arbitration hearings, conducted by Division Staff, are designed to avoid the technicalities of a legal court trial while affording the consenting unit owners and associations an opportunity to present their dispute to an impartial arbitrator. At the arbitration hearing, sworn testimony and evidence may be presented as in any administrative-type hearing. The decision of the arbitrator is binding and enforceable in circuit court. In the event a court suit is later filed (trial de novo is not precluded by the statute) the arbitration decision is admissible.

To use these services, a condominium unit owner or an association representative can, with mutual consent of the parties, request the Division Arbitrator to intervene. The Division will then send an attorney to conduct an impartial hearing in the city where the disagreeing parties reside. After considering the facts and issues, the arbitrator will, within thirty (30) days, render a decision that will bind both parties.

This provision has not changed the procedure for handling statutory violations under the existing Condominium Act. Statutory violations will continue to be processed by filing a condominium complaint directly with the Bureau of Condominiums. However, individuals wishing to use the voluntary binding arbitration services should request an application (petition) and a copy of the rules of arbitration from: Division of Florida Land Sales, Condominiums and Mobile Homes; The Johns Building; 725 South Bronough Street, Tallahassee, Florida 32301-1927; (904) 487-1137, or call toll free within Florida 1 (800) 342-8081. General inquiries concerning the arbitration process may also be directed to the above address, and marked "Attention: Condominium Arbitration Inquiry".

A Glossary of Commonly Used Condominium Terms

Amendment—A written statement of a change or revision in a bylaw or other governing document.

Annual Financial Report—A written statement on the financial status of the association for a given year.

Articles of Incorporation—The document creating the association responsible for operating the condominium. It describes the purpose of the association as well as its powers and duties.

Assessment—A unit owner's share of the amount of money required to pay the expenses of the association and the condominium.

Assessment (Special)—An assessment by the association in addition to the regular assessment. It may be required in emergencies or when the amounts budgeted were not sufficient to cover expenses.

Association—The entity responsible for the operation of a condominium. In most instances, the association is a not-for-profit corporation. The individual unit owners are members of the association.

Board Meeting—Any gathering of a quorum of the members of the board of directors or other representative body responsible for administration of the association for the purpose of conducting condominium business.

Board of Directors—Individuals responsible for the administration of the affairs of the association. Directors are usually unit owners.

Bylaws—The document which contains provisions for carrying out the internal affairs of the condominium. It provides for the administration of the association, various meetings, quorums, voting and other rules relating to the association.

Common Elements—The portion of the condominium property which is not included in the unit and which is owned jointly by all unit owners.

Common Expenses—All expenses properly incurred by the association for the condominium in carrying out its duties and responsibilities. The documents may name specific common expenses.

Common Surplus—The excess of all receipts of the association collected on behalf of a condominium (including, but not limited to, assessments, rents, profits, and revenues on account of the common elements) over the common expenses.

Condominium—A form of ownership of real property. The condominium property is made up of units which are individually owned by one or more persons and common property which is owned jointly by all unit owners.

Condominium Parcel—The unit together with the undivided share in the common elements.

Conversion—A condominium which is created from existing improvements.

Declaration of Condominium—The document which establishes the property as a condominium. The condominium is considered to be legally created when its declaration is recorded in the public records of the county where the condominium is located. The declaration contains legal descriptions of the property, including the units. It also describes each unit owner's undivided share in the common elements, membership and voting rights in the association, and covenants and restrictions on the use of the units and common elements.

Documents—The set of papers creating and describing the condominium. It includes such items as the declaration of condominium, articles of incorporation, bylaws, and any existing leases or contracts of the association.

Escalation Clause—A provision in a lease or other contract which states that the rental payment will increase at the same percentage rate as the Consumer Price Index or other nationally recognized measure of inflation.

Leasehold—The right to use property in exchange for rent.

Lien—A claim against property which allows the holder of a lien to take possession of the property to satisfy a debt. Florida law provides that condominium associations have liens on condominium units for unpaid assessments.

Limited Common Elements—A portion of the common elements which is reserved for the use of a particular condominium unit or units to the exclusion of all other units, even though they are owned by all of the unit owners. For example, a patio, which is not part of the unit to which it is attached but can be used only by the appurtenant unit, would be a limited common element. The declaration of condominium describes all limited common elements.

Multiple Condominium Community—A development which consists of more than one condominium. The condominiums often share common recreational facilities and are operated by one association.

Percentage of Ownership—The percentage of ownership is the interest each unit has in the common elements. Each unit has an assigned percentage. The total percentage of all units must equal 100. In Florida, a unit owner's

share in the common expenses must be in the same proportions as the individual ownership in the common elements.

Phase Condominium—A condominium which is created in stages. The developer has the option, but is not obligated, to add future land, units and other improvements to the initial condominium. As phases are added, the percentage of ownership in the common elements changes.

Proxy—Written authorization for one person to act or vote for another at a meeting of co-owners or members.

Quorum—The minimum number of representatives who must be present at the meeting of a deliberative body in order for business to be legally transacted.

Reserves—Money set aside for future repair or replacement of the common elements. The accumulation of reserve funds prevents the necessity of future large special assessments.

Special Assessment—An assessment for special purpose or because of inadequate budgeting of operating expenses.

Timeshare Condominium—A condominium in which one purchases an interest in a unit for a specified time period each year.

Undivided Interest in Common Elements—The percentage of common elements owned by the unit owner. The unit cannot be sold or bought separately from its undivided ownership interest in the common elements.

Unit—The part of the condominium property which is individually owned.

*Other Informational Brochures on Condominiums
by*

Division of Florida Land Sales, Condominiums and Mobile Homes
Guide to Purchasing a Condominium Unit

*Insuring the Condominium: An Insurance Guide
for the Condominium Unit Owner
Condominium and Cooperative Conversions*

This public document was promulgated at an annual cost of \$6,240.02, or \$.096 per copy to distribute information to the public.

The information contained herein is based on existing law and is subject to change.

May, 1985

If you have questions or wish to obtain brochures on other condominium topics, visit your local library or contact the Department of Business Regulation, Division of Florida Land Sales, Condominiums and Mobile Homes at one of the addresses below.

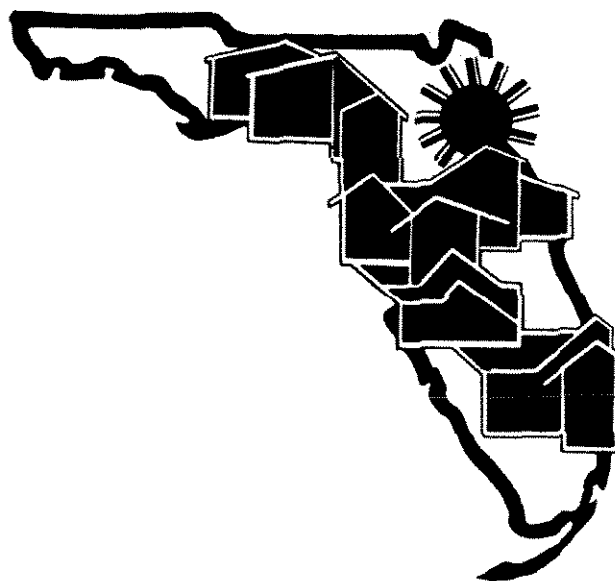
The Johns Building
725 South Bronough Street
Tallahassee, Florida 32301-1927
(904) 488-0725
1(800) 342-8081 (Within Florida)

Suite 903
1313 North Tampa Street
Tampa, Florida 33602
(813) 272-3845

Emerald Hills Plaza II
4651 Sheridan Street, Suite 480
Hollywood, Florida 33021
(305) 963-1440

Appendix F

DBR 340



UNIT OWNER RIGHTS AND RESPONSIBILITIES

State of Florida

**Department of Business Regulation
Division of Florida Land Sales, Condominiums
& Mobile Homes
The Johns Building
725 S. Bronough Street
Tallahassee, Florida 32301-1927**

Introduction

The State of Florida, through its Condominium and Cooperative Acts, provides for a number of rights for owners of condominium and cooperative units. These rights are balanced with several major responsibilities tied to these forms of real property ownership. The purpose of this brochure is to summarize unit owners' rights and responsibilities under the Condominium Act (Chapter 718 of the Florida Statutes) and the Cooperative Act (Chapter 719 of the Florida Statutes). The rights are listed in the order that they appear in the statutes. The specific statute reference is listed after each right. You should refer to that section of the statute for the exact language of the designated provision. For a copy of these statutes or for more information pertaining to these rights and responsibilities, you may contact: The Education Section, Bureau of Condominiums, Johns Building, Tallahassee, Florida 32301-1927, (904) 488-0725. Toll free in Florida 1-800-342-8081.

Rights

Unit owners have the right to ...

1. Exclusive ownership of the condominium unit, exclusive lease of the cooperative unit. Section 718.103(23) and Section 719.103(14)
2. Membership in the association. Section 718.104(4)(i) and Section 719.105(1)
3. Vote as described in the declaration of condominium or cooperative documents. Section 718.104(4)(i) and Section 719.105(1)
4. Veto any changes in the share of ownership or *common expenses and material alterations in their unit* unless the declaration as originally recorded provides for less than 100% approval for such changes. Section 718.110(4) and Section 719.106(3)
5. Full voting rights appurtenant to the unit. Section 718.106(2)(d), no provision in the Cooperative Act.
6. Use of the common elements and association property without payment of a fee unless such use is the subject of a lease between the association and the unit owner. Section 718.111(4), no provision in the Cooperative Act.
7. Inspect the condominium or cooperative records at reasonable times. Make or obtain copies of the records at the reasonable expense, if any, of the association member. Section 718.111(12) and Section 719.104(2) *(Copies not provided for in Chapter 719).
8. Inspect all association insurance policies at any reasonable time. Section 718.111(11)(a) and Section 719.104(3)
9. Inspect minutes of all meetings of unit owners and the board at any reasonable time. Section 718.111(12)(a) 6. and Section 719.106(1)(e)
10. Receive a financial report of the actual receipts and expenditures of the association annually. Section 718.111(13) and Section 719.104(5)
11. Vote by proxy. Section 718.112(2)(b)1. and Section 719.106(1)(b)
12. Right to revoke a proxy. Section 718.112 (2)(b)2. and Section 719.106(1)(b)
13. Receive 48-hour notice, posted conspicuously on the condominium or cooperative property, of board meetings. Section 718.112(2)(c) and Section 719.106(1)(c)
14. Be permitted admission to all board meetings at which a quorum of the board is conducting condominium or cooperative business. Section 718.112(2)(c), Section 719.106(1)(c) and Rule 7D-23.01(1), Florida Administrative Code
15. Be advised, in the posted notice described in Item-13, when the board meeting is meeting for the purpose of considering assessments and the nature of any such assessments. Section 718.112(2)(c) and Section 719.106(1)(c)
16. Be nominated from the floor to be a candidate for board membership. Section 718.112 (2)(d)1. and Section 719.106(1)(d)
17. Receive at least 14 days' written notice of the annual meeting. The notice must also be posted in a conspicuous place on condominium property. Section 718.112(2)(d)2. and Section 719.106(1)(d)
18. Receive not less than 14 days written notice of budget adoption meetings and a copy of the proposed budget (Section 718.112(2)(e), condominiums). Receive not less than 30 days written notice of budget adoption meetings and a copy of the *proposed budget* (Section 719.106(1)(f), Cooperatives).
19. Object, along with a majority of the other unit owners, to any budget over 115% of the previous year's assessments. Section 718.112 (2)(e) and Section 719.106(1)(f). In developer controlled associations, a majority of the unit owners must approve an assessment for any year greater than 115% of the prior year's assessment. Section 718.112(2)(e) and Section 719.106(1)(f)5.
20. Pay assessments on a quarterly or more frequent basis. Section 718.112(2)(g) and Section 719.106(1)(g)
21. Join with a majority of the other unit owners to recall any board member. Section 718.112 (2)(k) and Section 719.106(1)(k)
22. Arbitration of dispute involving recall of board members. Only one side needs to submit this type of dispute and the result will be binding on both parties. Section 718.112(2)(k), no provision in the Cooperative Act.
23. Apply to the circuit court for the appointment of a receiver if the association fails to fill vacancies on the board sufficient to constitute a quorum. Section 718.1124 and Section 719.1064

24. Expect maintenance of the common elements by the association. Section 718.113(1) and Section 719.103(2)
25. Require the association to enforce a recorded claim of lien against their condominium parcels by filing a notice of contest of lien. Section 718.116(4)(a), and Section 719.108(4).
26. Receive written notice from the association 30 days before foreclosure action is filed. Section 718.116(5)(b), no provision in the Cooperative Act.
27. Require the association to provide a certificate showing the amount of unpaid assessments against them with respect to their parcels. Section 718.116(7) and Section 719.108(6)
28. Receive notification of any special assessment which shall state the specific purpose of the special assessment. Upon completion of the project any excess funds will be considered common surplus. If the funds are not used for the purpose intended, the funds will be returned to the unit owners. Section 718.116(9), no provision in the Cooperative Act.
29. Receive notice from the association of its exposure to liability in excess of insurance coverage protecting it against legal action within a reasonable time so the unit owners have the opportunity to intervene and defend on their own behalf. Section 718.119(3), no provision in the Cooperative Act.
30. Use the common elements, common areas and recreation facilities serving their condominium/cooperative according to the association's properly adopted rules and regulations. Sections 718.106, 718.123 and Sections 719.105, 719.109.
31. Obtain access to any available franchised or licensed cable television service without charge to receive such service except those charges normally paid for like services by residents of single family homes except for installation charges agreed to between the residents and providers of the service. Section 718.1232, no provision in the Cooperative Act.
32. Arbitration of disputes based on voluntary submission of both sides to the arbitration proceedings. Section 718.1255, no provision in the Cooperative Act.
33. Bring action for damages or for injunctive relief, or both, against the association, another unit owner, directors designated by the developer or any director who willfully and knowingly fails to comply with Chapters 718, 719, or the association and condominium/cooperative documents. The prevailing party is entitled to recover reasonable attorney's fees. Section 718.303(1) and Section 719.303(1)

For more information contact: The Education Section,
Bureau of Condominiums, Johns Building, Tallahassee,
Florida 32301-1927 (904) 488-0725 or toll free in
Florida 1-800-342-8081

Other Informational Brochures
on Condominiums
by
Division of Florida Land Sales,
Condominiums and Mobile Homes

Condominium Living in Florida
Guide to Purchasing a Condominium Unit
Insuring the Condominium: An Insurance Guide
for the Condominium Unit Owners
Condominium and Cooperative Conversions

You may obtain copies of these materials from your local
library or from the Division of Florida Land Sales,
Condominiums and Mobile Homes from the Tallahassee
office or:

Suite 903
1313 North Tampa Street
Tampa, Florida 33602
(813) 272-3845
or
Emerald Hills Plaza II
4651 Sheridan Street, Suite 480
Hollywood, Florida 33021
(305) 963-1440

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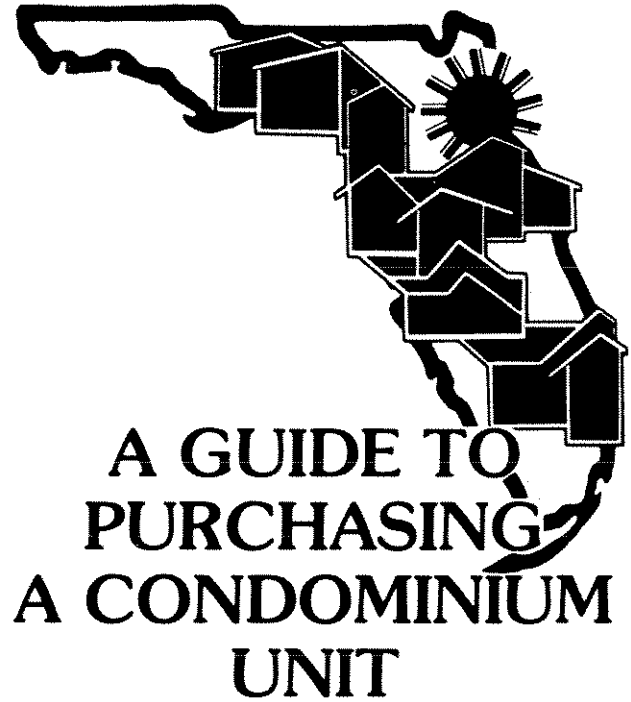
The information contained herein is based on
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May, 1985

Appendix G

DBR-337
(9/85)

Department of Business Regulation
Division of Florida Land Sales,
Condominiums and Mobile Homes
725 South Bronough Street
Tallahassee, Florida 32301-1927



Department of Business Regulation
Division of Florida Land Sales,
Condominiums and Mobile Homes
725 South Bronough Street
Tallahassee, Florida 32301-1927

Introduction

Condominiums have become a very popular form of housing in Florida. Many buyers, however, are not familiar with the condominium concept nor the State of Florida's statutory protections for buyers. The purpose of this pamphlet is to increase awareness of the condominium concept as well as to increase the knowledge of potential condominium buyers. Florida law applies only to situations where a unit is being bought directly from a developer. The statutory protections described in this brochure **DO NOT APPLY** if you buy your unit from another unit owner. However, this should not preclude you from considering and asking the same kind of questions a prospective purchaser would ask of a developer.

The first part of the pamphlet focuses on factors to consider **before** purchasing a condominium unit. This section includes a worksheet to assist in estimating the ongoing cost of condominium ownership. The second section of the pamphlet describes some buyer protections under the Florida Condominium Act.

Part I: Things to Consider Before Purchasing a Unit

This may be the first question a potential purchaser of a condominium unit asks "What exactly is a condominium?" Quite often when the term "condominium" is used people immediately picture a tall, high-rise building. This should not be the case.

The word condominium comes from two Latin words meaning common ownership or control. In a typical form of home ownership a person owns property as well as the housing facility upon the property. In the condominium concept you own your unit plus you have an ownership interest in the common elements of the condominium. This is the common ownership or common control referred to previously. This type of ownership can be found not only in high-rise buildings but also in low-rise developments, garden type, row structure, semi-detached or detached townhouse structure and even mobile home parks.

The benefits as well as the disadvantages of condominium living should be weighed carefully before a decision to purchase a condominium unit is made. Some of the benefits may include income tax savings, equity build up, investment rewards, minimized upkeep, location and amenities. The disadvantages may include higher population density, restrictions on living, responsibility of co-ownership, majority rule and reduction of privacy.

Living in a condominium is like living in a small democratic society. As with all democracies, the system works best with the **active** involvement of **all** members. While you do not **have** to get involved in the organizational structure

of operating a condominium, you would be wise to take part in it. After all, you are making an investment in your unit and the portion of the common elements you have bought. The least you can do is attend the meetings and vote on the issues to try and control your investment in a manner you feel is best. Bear in mind though, where a majority rules, there also exists a minority.

In addition to questions normally asked when purchasing a residence, the following should be asked about condominiums. The list is not comprehensive but covers areas often overlooked by people who have never considered a condominium.

1. What are your ownership rights in the common elements, your voting rights in the association, and your share in the common expenses?
2. How are the unit boundaries defined?
3. What are the restrictions on the use of the common elements and the unit?
4. Does the board of directors have the authority to set the monthly assessments, or do the unit owners set the monthly assessments? Are there restrictions on how much the board of directors may spend without unit owner approval?
5. Does the board of directors of the association have the authority to make special assessments without unit owner approval?
6. Are there any leases or contracts associated with the condominium? If so, what are their terms?
7. Are there clauses in the documents that state you ratify and approve of all actions of the developer? If so, do you understand all of the provisions of the documents and accept and ratify what the developer has done?
8. Exactly what items will the unit owner be personally responsible for maintaining?
9. Is the condominium a phase condominium? Developers are not required by law to complete all proposed phases. If so, how many units will eventually be added to the condominium and what impact will they have on the use of the common facilities? In what phase are the recreational facilities to be built? If the recreational facilities are planned for one of the first phases, what will be the assessments if later phases are not added? If the recreational facilities are in a latter phase and the developer does not complete the phase development, how will you feel? What is the proposed time schedule for adding the phases to the condominium?
10. Are the expenses as set forth in the estimated operating budget realistic? Are the amounts too low and if so, would it mean increases in assessments when the developer turns over control of the condominium association to the unit owners? You may obtain guidance on these questions by comparing the estimated operating budgets of the different condominiums you are considering.
11. Is the condominium being created from previously occupied property? (a "conversion") If so, what is the condition of the property and will major repairs be

required in the near future? Is the developer providing written warranties? (See Condominium/ Cooperative Conversion brochure)

12. What is the quality of the construction?
13. What is the reputation of the developer?
14. Is the condominium one of a number of condominiums operated by one association? If so, how are the various condominiums related? Will each condominium be represented on the board of directors?
15. Has the developer filed the condominium documents with the Division of Florida Land Sales, Condominiums and Mobile Homes?

The answer to these and other questions you may have can be found in the "condominium documents". The developer is required to file these documents, which consist of the declaration of condominium, articles of incorporation of the association and bylaws of the association with the Division of Florida Land Sales, Condominiums and Mobile Homes, Bureau of Condominiums before he offers the units for sale. The developer is also required to give each purchaser a copy of each of these condominium documents. Inspect these documents thoroughly **before** you purchase a condominium unit. The restrictions within these documents will govern your life for the period of time you own your condominium unit. No matter how formidable these documents appear, it is for **your own** protection and to your advantage to carefully read and understand what the documents contain. You may require the services of an attorney to help you interpret this paperwork.

There are many other factors which should be considered. Many of these relate to the unique needs of each buyer, who must thoroughly explore the condominium in order to make a decision. The condominium you choose should reflect the lifestyle you and your family desire. Its conveniences, comforts and space should suit your needs, tastes, and budget.

Cost of Condominium Ownership

The cost of buying and maintaining a condominium unit requires a major investment and the **continuing obligation** to pay common expenses in addition to personal expenses, such as mortgage payments.

These should be carefully evaluated. While the cost will be a major factor in your decision, due consideration should also be given to desired living style, location, attractiveness of the residence, and many other subjective factors.

To assist in evaluating the cost of condominium ownership, the following worksheet is provided to identify and organize the basic cost information.

Section 1 itemizes the basic information for your analysis. The purchase price and the number of square feet

provide a basis for comparing the relative cost of one condominium with another. The cost per square foot will vary considerably depending upon appearance, quality of construction, location, and amenities.

The initial cash investment is detailed in Section 2. Purchasing a condominium usually involves significant initial costs for moving, refurbishing, and decorating. In addition, there may be other initial costs associated with legal fees, title insurance, and special costs, often called "points," associated with obtaining a mortgage. These closing costs vary widely and can run as high as three to five percent of the cost of the condominium unit. In renting, by contrast, there are no closing costs, but it is common to require a deposit equivalent to one to three months rent.

The monthly cash requirements are outlined in section 3. Most mortgages have a constant monthly payment that includes both principal and interest. As the mortgage matures, however, the portion of the payment for interest gradually declines while the portion paid for reduction of the principal gradually increases. For example, a mortgage with a life of 25 years will have its principal balance reduced by one to two percent per year in the first 10 years and two to three percent in the second 10 years.

Real estate taxes, insurance, assessments for maintenance and repair of the common elements, and maintenance of the individual unit are other monthly expenses for which condominium unit owners are responsible. You should expect these costs to rise during inflationary periods.

Payments for interest and real estate taxes may reduce your federal income taxes if you itemize your deductions. This should be considered in determining your effective monthly cost.

You may wish to consult an accountant, banker, or lawyer for advice on whether a prospective condominium purchase would fit your particular budget.

WORKSHEET FOR CALCULATING CONDOMINIUM OWNERSHIP COSTS

Section One—Cost of Condominium Unit

1. Purchase price \$ _____
 2. Square feet _____
 3. Cost per square foot \$ _____
- (purchase price divided by number
of square feet)

Section Two—Initial Cash Investment

4. Downpayment \$ _____
5. Closing costs \$ _____
6. Repairs \$ _____
7. Moving expenses \$ _____
8. Total initial costs \$ _____

Section Three—Monthly Cost

9. Payment on mortgage \$ _____
10. Real estate taxes \$ _____
11. Insurance premium \$ _____
12. Association assessments \$ _____
13. Unit maintenance \$ _____
14. Utilities \$ _____
15. Total monthly cost \$ _____

Part Two: The Purchase

Reservation Deposits

Often the first legal document presented to prospective purchasers is a reservation deposit agreement, which gives the prospective purchaser an option to purchase a unit at a later date should the condominium be developed. It is not a binding contract. Either you or the developer may back out of the agreement at any time. It is possible that the purchase price will be different from the price stated in the reservation agreement.

All money which a developer collects from you under a reservation agreement must be made payable to the escrow agent. This is to ensure that the funds are deposited with the agent. You should look for the name and address of the escrow agent, who must give you a receipt for the deposit.

You or the developer may, at any time, make a written request to the escrow agent for your deposit to be immediately refunded.

Under Florida law, the purchaser is entitled to any interest earned on the deposit unless the reservation deposit agreement provides otherwise. This should be clarified at the outset. The Division reviews the reservation and escrow agreement forms to determine if they comply with the law; however, it does not judge the merit of the program nor does it monitor escrow accounts.

Sales Deposits

If you are purchasing a condominium unit in which the construction, furnishing, and landscaping of the condominium property are not substantially complete, your deposit money is partially protected under Chapter 718, Florida Statutes, the Condominium Act. In pre-constructed condominiums, deposits up to ten percent of the sales price must remain in an escrow account. Deposits in excess of ten percent may be used by the developer for construction purposes if so provided by the purchase contract. For example, in the sale of a condominium unit priced at \$50,000, only \$5,000 of the deposit must remain in escrow. Any amount in excess of \$5,000 could be used by the developer for construction.

If you are purchasing a unit in a condominium in which the furnishing, landscaping and construction are substantially complete, the Condominium Act does not require that the deposits be escrowed. You should check your purchase contract to determine if your deposit is protected.

To cancel the contract and obtain a refund of your deposit, you must provide written notice to the developer of your intention to do so. It is suggested (not required by law) that you send this request by certified mail, return receipt requested, so that you have proof the developer did indeed receive your notice.

Condominium Documents

The developer must provide you with one copy of each of the following items:

- **declaration of condominium**

The declaration will contain important information. This information is concerning: submitting the development to the condominium form of ownership; membership and voting rights of unit owners in the condominium association; how unit owners share in the common expenses, common surplus and ownership of the common elements; the outline of the phase development plan if applicable; identification of units including plot plan and survey of improvements; use restrictions; assessments; taxation; how physical alterations may occur within the development; insurance; rights of the developer; the operational aspect of the recreational facilities; procedures for amending the declaration and may include many other items.

- **articles of incorporation**

The articles of incorporation of the association may include: the purpose of the articles, the powers granted to the association (i.e.: make and collect assessments, control of expenditure of funds, maintaining the property, etc...) rights of members, number and election of directors and officers, and indemnification clause for directors and officers, a procedure for amending the articles, and other applicable items.

- **bylaws**

The bylaws will contain information relating to the operation of the association. For example, types, frequency and locations of meetings, notice requirement of meetings, powers and duties of the association, duties of officers and directors, a procedure for amending the bylaws, various use restrictions, financial operation requirements and other pertinent information.

- **estimated operating budget for the condominium**

- **purchase agreement**

- **receipt for condominium documents**

Remember that your purchase agreement with the developer is voidable for 15 days after the agreement is executed by the buyer **and** the buyer's receipt of the condominium documents. Be sure you have indeed received all the documents for which you are signing the receipt.

- **plot plan and floor plan.**

In addition, if there are leases, contracts, or covenants and restrictions associated with the condominium development, they must be provided. In larger developments, you will be given a prospectus, which summarizes some of the major points in the other documents.

Read the required disclosure documents to make sure that all the obligations and restrictions contained in the documents are understood. These legal documents are usually complex and often difficult to understand. Many buyers consult with attorneys for assistance in reviewing them.

For detailed information on the above items and other statutory requirements, you may request a copy of the Condominium Act from the Division of Florida Land Sales, Condominiums and Mobile Homes.

OTHER INFORMATIONAL BROCHURES

Condominium and Cooperative Conversions

Condominium Living in Florida

Insuring the Condominium

Unit Owner Rights and Responsibilities

You may obtain these materials (free of charge) from your local library or the Division of Florida Land Sales, Condominiums and Mobile Homes, Bureau of Condominiums, 725 South Bronough Street, Tallahassee, Florida 32301-1927, (904) 488-0725 or toll free in Florida 1-800-342-8081.

Tampa Field Office
1313 North Tampa Street, Suite 903
Tampa, Florida 33602
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Hollywood Field Office
Emerald Hills Plaza II
4651 Sheridan Street, Suite 480
Hollywood, Florida 33021
(305) 963-1440

The information contained herein is based upon current law and is subject to change.

Sept. 1985

This public document was promulgated at an annual cost of \$1,875.80 or .0625 per copy to inform citizens about condominium purchases and related statutory protections.



**An Insurance Guide for
Florida Condominium
Unit Owners
Prepared by the Florida Association
of Insurance Agents in conjunction
with the
State of Florida
Department of Business Regulation
Division of Florida Land Sales,
Condominiums & Mobile Homes
Bureau of Condominiums
The Johns Building
725 S. Bronough Street
Tallahassee, Florida 32301-1927**

**State of Florida
Department of Business Regulation
Division of Florida Land Sales, Condominiums
& Mobile Homes
The Johns Building
725 S. Bronough Street
Tallahassee, Florida 32301-1927**

Introduction

Along with the many advantages inherent in the unique characteristics of condominium home ownership, there are unique insurance hazards and problems. Fortunately, however, there are also unique insurance products designed to deal with these hazards and reduce risks of financial loss.

The condominium declarations and bylaws, along with *certain Florida Statutes*, set forth the responsibilities and risks assumed by the association, and those assumed by the individual unit owners. Because there is no standardization of declarations and bylaws, there is no standard insurance product to fit all needs. Rather, there are basic products, with many flexible options, to permit the thoughtful condominium unit owner, in consultation with his Independent Insurance Agent, to adequately cover against risks of loss.

This booklet was prepared to help the Florida condominium unit owner recognize his hazards, measure those hazards, and be aware of kinds of insurance he may wish to consider. Necessarily, the information herein is a general guide only and specific questions should be resolved by the terms of the specific policy contract.

The Florida Condominium Unit Owner's Policy

This form of protection is a variation upon the popular homeowners "package" protection utilized by most residence owners and renters. It provides protection against a wide range of hazards for personal property both at and away from the condominium unit, for additions and alterations to the unit, and for liability protection against injuries or damage to others arising from the unit itself or personal activities away from the unit. In addition, there is a wide range of options to expand the basic coverage.

1. Coverage on Personal Property

The Condominium Unit Owner's Policy covers personal property (clothing, furniture, other property which is not "additions and alterations") against many perils, including fire, windstorm, vandalism and theft anywhere in the world. It is the unit owner's responsibility to establish the desired amount of

coverage. This amount may be based upon replacement value or actual cash value (the latter being replacement cost less allowance for depreciation). For this purpose, it is recommended that a household inventory be prepared. This will not only establish an appropriate amount of insurance, but also assist materially in making any claim in the event of a serious loss.

The most common deductibles applicable to each property loss are \$100 and \$250. Usually, arrangements may be made for other deductibles.

Special limits apply to certain types of property such as money, securities, jewelry, furs, silverware, boating equipment and guns. The special amounts vary in some company policy forms from \$100 to \$2,500 or more. Often these limits can be increased, or the unit owner may desire "all-risk floater" coverage on certain types of valuable property such as jewelry, furs, fine arts, boats, silverware, guns, musical instruments, photographic equipment, golfers' equipment, stamp and coin collections or other "special" property.

Theft coverage in the basic unit owner's form is excluded upon rental of the unit to others. Optionally, the forms may be amended to provide such coverage.

Another of the more important options (which may be included in some company forms) is called Theft Coverage Extension. Basic Coverage applies to burglary of personal property from automobiles and boats, while away from the premises, only when locked and there are visible signs of forcible entry. This option extends coverage to include theft losses whether or not entry is forcible.

2. Unit Owner's Additions and Alterations

As distinguished from personal property, "additions and alterations" are those types of property which comprise a permanent attachment to the realty, for example: floor coverings, wall coverings, built-in cabinets and appliances, tile, light fixtures. This area of loss exposure demands the close attention of the condominium unit owner. Two important questions must be resolved: (1) what property is the responsibility of the unit owner and (2) what is a proper valuation of such property?

Part of the answer to the first question may be found in Section 718.111(11)(b) of the Florida Statutes which became effective October 1, 1979, was modified July 2, 1980, and was modified again July 1, 1981 and October 1, 1984.

To provide a bit of historical background, most condominium policies in Florida were written on the "bare walls" concept prior to October 1, 1979. This meant that the association insurance policy was not responsible for *anything* on the interior of the unit. The association was only required to insure the common elements; i.e., condominium property which is not included within the units (easements through units for conduits, plumbing, wiring and other facilities for the furnishing of utilities, servicing the units and the common elements; and the property and installations required for the furnishing of utilities and other services to more than one unit or to the common elements). The unit owners had to insure their personal property and *everything* contained within the unfinished interior surfaces of their units, within the interior bare walls—cabinets, sinks, tubs, toilets, chandeliers, partition walls, kitchen appliances, fixtures, counter tops and coverings on the floors, walls and ceilings (carpet, wallpaper, paneling and paint).

Many unit owners did not understand the extent to which they needed to purchase insurance coverage to protect the property within their respective units. As a result, there were many gaps in their insurance. In one condominium, a fire destroyed a large portion of the condominium, but many unit owners lacked sufficient insurance to restore their units. Consequently, effective October 1, 1979, the Florida Legislature amended the Condominium Act to provide that all hazard policies issued to protect condominium buildings were to provide coverage for "fixtures, installations or additions comprising that part of the building within the *unfinished* interior surfaces of the perimeter walls, floors and ceilings of the individual units initially installed, or replacements thereof in accordance with the original plans and specifications."

Until October 1, 1984, the board of directors had the responsibility for obtaining and maintaining "adequate" insurance not only to protect the association and the common elements, but also to insure *all* improvements (or replacements thereof of like kind or quality) within the interior of the

condominium units. This meant that the association policy provided insurance on property of individual unit owners in which it neither had an ownership interest nor the responsibility for maintenance or repair.

Since the association had insurance coverage on the property within the interior of the units, many unit owners did not carry their own insurance (or simply carried minimum coverage). Unit owners were frequently frustrated in seeking reimbursement for their casualty losses. For example, often the association's deductible was larger than the insured loss and neither the association policy nor the homeowner's policy afforded coverage. Further, these problems seem to center around damage to the walls or carpeting, from water intrusion or water seepage. Other losses on which unit owners experienced difficulty were from water pipes breaking, or water leaking from units above.

Section 718.111(11)(b), F.S. (1984) now states, in part, that insurance on condominium buildings must include "fixtures, installations or additions comprising that part of the building within the unfinished interior surfaces of the perimeter walls, floors and ceilings of the individual units initially installed, or replacements thereof of like kind or quality, in accordance with the original plans and specifications, or as existed at the time the unit was initially conveyed if the original plans and specifications are not available. However, the word 'building' shall not include floor coverings, wall coverings or ceiling coverings." Unit owners are to be considered additional insureds under the policy. This means carpeting and padding on the floor, not the floor; paint or tile on the wall, not the wall; paint or popcorn or textured finish on the ceiling, not the ceiling. The association policy will continue to insure the fixtures, installations or additions comprising that part of the building within the unfinished interior surfaces of the individual units—such items as kitchen cabinets, sinks, tubs, chandeliers, toilets, partition walls, built-in appliances, fixtures and counter tops.

It is important to note that the policy carried by the condominium association will apply only to those interior items "initially installed, or replacement thereof of like kind or quality, in accordance with the original plans and specifications or as existed at the time the unit was initially conveyed." Any such interior items additionally installed by the unit owner after acquisition of the unit, or any increase in value created

in upgrading the existing interior items, would have to be protected by the unit owner unless responsibility is assumed by the condominium association under its declarations and/or bylaws, and covered by the association insurance. To avoid under or over insurance, the unit owner should clearly identify the property for which there is personal responsibility. It is also important to determine whether or not the condominium association carries a high deductible which may preclude the payment of relatively minor damages on interior unit items under the association policy. If so, coverage should be provided by the unit owner. The Florida Association of Insurance Agents recommends the unit owners should protect their property by increasing the amount of additions and alterations insurance in their Homeowners policies.

The Division's position in reference to the "coverings" is as follows:

1. Condominium associations may not insure the floor, wall and ceiling coverings within an individual unit owner's unit in policies with effective dates on or after October 1, 1984. However, condominium documents that, as of October 1, 1984, allow for such coverage will, on and after October 1, 1984, supersede the Condominium Act and the association must insure these items.

In order to determine if your documents provide for such coverage, the documents **must**:

- a. **Require, obligate or mandate** the association to acquire insurance as opposed to merely authorizing or "giving permission" to the association to insure these items.
- b. Define what is to be insured. This is sometimes difficult to determine as most documents do not specifically mention the "coverings" but some examples of wording that would include "coverings" might be:
 - (1) "...all of the insurable improvements within the condominium..."
 - (2) "...the building and all other insurable improvements to the property..."
 - (3) "...all of the insurable improvements of the entire condominium, including the common elements and the respective units..."
- c. **Not** contain wording which would automatically incorporate changes in Chapter 718, Florida Statutes.

It is extremely important, therefore, that a review of the condominium documents be made. Since the Division does **not** have the authority to interpret the documents, you may wish to consult independent legal counsel.

2. Condominium documents may not be amended on or after October 1, 1984, to allow the association to provide coverage for the "coverings."
3. Existing policies with effective dates prior to October 1, 1984, may be amended by endorsement to reduce the coverage to that indicated by the statute. If not so endorsed, they will continue to provide the prior protection until expiration date.

A new section 718. 111(11)(c) also was added effective October 1, 1984:

"Homeowner's insurance policies issued to individual unit owners shall provide that the coverage afforded by such policies is excess over the amount recoverable under any other policy covering the same property without rights of subrogation against the association."

This amendment will allow unit owners to make claims under their own policies for any amounts not recovered under the association's policy as a result of a high association deductible. (Unit owner's policies usually are written with a \$100 or \$250 deductible.)

The Condominium Act also requires the Association to notify the unit owners of changes made to the Association insurance policy. This is set forth in section 718.111(11)(d), F.S. Each association shall mail a notice to each unit owner not less than 45 days prior to the effective date of any renewal of, or amendment to, the association's insurance coverage reflecting the changes being made in the association's policy. This notice must include the description of the property previously covered by the association which will no longer be covered, and the effective date of such change.

The second question is more difficult to resolve. The unit owner should know the cost of additions and alterations made at personal expense. However, property installed by the builder or a previous owner may have to be evaluated with the help of the association, suppliers, contractors and others. Establishing an amount of insurance deemed adequate for a serious or total loss to the additions and alterations is most important.

The basic unit owner's policy automatically provides \$1,000 additional coverage on alterations and additions and covers for the same perils which apply to personal property. However, while personal property may be covered for its actual cash value or replacement value, additions and alterations are covered for their replacement value, with no deduction for depreciation, if actually replaced (subject to the basic policy deductible). This fact should be taken into consideration when determining the valuation of additions and alterations for insurance purposes.

The \$1,000 limit on additions and alterations may be increased to any desired amount, and the perils may be broadened to a "all risk" (subject to certain exclusions). With floor, wall and ceiling coverings no longer insured under the condominium association policy, special consideration should be given to these coverage improvements.

3. Other Property

If the condominium unit owner personally owns a separate, detached structure on the association premises (such as a storage building or cabana), it may be covered under a Unit Owner's policy for the same perils as apply to additions and alterations (as long as the structure is not rented to others nor used for business purposes).

If the condominium unit owner personally owns a part of the building which is not within the individual apartment's inner walls (an enclosed balcony, for example) it, too, may be covered for the same additions and alterations perils under a Unit Owner's policy.

4. Loss of Use

The Condominium Unit Owner's Policy covers the additional (above normal) living costs incurred during a period of time when the unit is untenantable because of damage to the unit or to the building from a peril insured against. The basic limit of coverage which is automatically included is 40% of the limit selected to cover personal property. This limit maybe increased, if desired.

When the unit owner purchases the option to broaden coverage for rental of the unit to others, as described under "Coverage on Personal Property," that option also provides for application of the Additional Living Expense coverage to loss of rents

which would have been realized during the period of untenantability.

5. Personal Liability and Medical Payments

The Condominium Unit Owner's Policy includes protection against claims for bodily injuries and damage to property of others arising from within the unit, or personal activities away from the unit. In addition, and without regard to whether or not the unit owner is legally liable, the policy pays for medical and related bills incurred by a member of the public accidentally injured in the unit or arising from personal activities of the unit owner.

A wide range of limits is available for these coverages. While not available under the homeowners policy, many persons buy a separate "Personal Umbrella Policy" to provide protection against a catastrophic judgment. For example, a limit of \$300,000 per occurrence might be selected for the Condominium Unit Owner's Policy, with a Personal Umbrella Policy increasing the protection to \$1,000,000 or more.

If any business pursuits are conducted in the unit, or if the unit is rented to others, the agent should be fully informed to assure proper amendments to the policy.

One of the more important limitations of the liability and medical payments coverage relates to boats. If the unit owner owns an outboard motor of 25 horsepower or less, or a sailboat less than 26 feet in length, liability protection is automatically included. Some policies provide coverage for inboard or inboard/outboard boats of limited horsepower. Where liability and medical payments protection for boats is not included, coverage may, as an option, be extended to provide the necessary protection.

Liability for golf carts, while used only for golfing purposes, is basically covered. Special arrangements are necessary for golf carts if used for non-golfing purposes, such as going to or from the golf course or while on public streets.

The unit owner is advised to be aware of and satisfied with the liability insurance carried by the condominium association. He should be sure that (1) an adequate limit is carried by the association, and (2) the association policy provides that unit owners

are individually protected in the event of a claim directly against them.

6. Loss Assessment Coverage

If the condominium association suffers a loss or claim which is not insured by the association, then, of course, the unit owners may be assessed for the necessary funds which must be raised. This again makes it incumbent on all unit owners to be aware of and satisfied with the insurance program of the association.

The unit owner may, however, take steps to avoid assessment losses by purchasing "Loss Assessment Coverage" as an option under his own Condominium Unit Owner's Policy. This coverage, subject to a \$250 deductible, reimburses the unit owner for assessments arising from (1) property losses, if covered by a peril insured against under his own unit owner's policy; (2) liability losses covered under his own unit owner's policy; and (3) Directors and Officers claims arising from acts of elected directors, officers or trustees serving without income.

Examples of the need for the coverage would include (1) a large liability claim exceeding the limit of the association's coverage; (2) loss to the association's property by a peril not insured against in the association's policy but covered by the unit owner's policy; (3) a property loss wherein the association's amount of insurance was inadequate; (4) a property loss wherein the association's insurance did not respond because of a high deductible. In the case of a Loss Assessment payment as a result of the association's deductible, no more than \$1,000 will be paid under each unit owner's policy.

It is emphasized that this option does not cover assessments from every cause. For example, if the association does not carry flood insurance, any assessment for such a loss is not covered by Loss Assessment Coverage, because the Condominium Unit Owner's Homeowners Policy also does not cover flood or rising waters.

If this optional coverage is desired, the difficulty in proper purchasing is the decision on what would be an appropriate amount of coverage. The decision must be made by the unit owner, and should be based on his knowledge of and degree of satisfaction with the insurance carried by the association.

7. Rental of Unit to Others

Special policy provisions should be made whenever your unit is rented to others, whether it be on a short-term or a long-term basis. A separate insurance contract may be necessary if the unit has been purchased for investment purposes and is rented to others continuously. Please note some of the rental limitations referred to under: 1. Coverage on Personal Property, 2. Other Property, 3. Loss of Use, and 4. Personal Liability and Medical Payments.

Other Forms of Insurance

The foregoing information briefly describes the Condominium Unit Owner's Homeowners' Policy and principal options, which is the sole purpose of this booklet. Flood insurance, underwritten by the Federal Insurance Administration and available through most home insurers, is an important consideration for those living in coastal and flood prone areas. For information on Flood Insurance, Florida's State Coordinating Agency is: Department of Community Affairs, 2571 Executive Center Circle East, Howard Building, Tallahassee, Florida 32301 (904) 488-4925

Also, renter's insurance covers the contents of the condominium against theft and other hazards while occupied by a tenant. Other kinds of coverage which are not unique to condominium unit owner's needs, such as automobile, life and health insurance, may also be appropriate.

Other Informational Brochures on Condominiums
by

Division of Florida Land Sales, Condominiums
and Mobile Homes

Condominium and Cooperative Conversions
Condominium Living in Florida

Guide to Purchasing a Condominium
Unit Owner Rights and Responsibilities

You may obtain copies of these materials from your local library or from the Division of Florida Land Sales, Condominiums and Mobile Homes.

Bureau of Condominiums
The Johns Building
725 S. Bronough Street
Tallahassee, Florida 32301-1927

or call (904) 488-0725

Toll free within Florida 1-(800) 342-8081

The information contained herein is based on existing law and subject to change.

May, 1985

Insurance Checklist

PERSONAL PROPERTY COVERAGE

- ☐ Estimated actual cash value: amount to apply within unit \$_____ OR Estimated replacement value: amount to apply within unit \$_____
- ☐ Special limits (money, securities, jewelry, furs, silverware, guns, boats): _____
- ☐ Floater coverage (jewelry, furs, fine arts, silverware, cameras, sporting goods, etc.—itemized): _____
- ☐ Rental Coverage
- ☐ Theft Coverage Extension
- ☐ Other: _____

ADDITIONS AND ALTERATIONS

- ☐ Estimated replacement value: amount of Coverage \$_____
- ☐ Broadened perils ("all-risk" coverage)

ADDITIONAL LIVING EXPENSE

- ☐ Amount of coverage \$_____

OTHER PROPERTY

- ☐ Estimated actual cash value: amount of coverage \$_____

PERSONAL LIABILITY, MEDICAL PAYMENTS

- ☐ Personal Liability limit \$_____
- ☐ Medical Payments limit \$_____
- ☐ Watercraft Liability
- ☐ Personal Umbrella Liability limit \$_____

LOSS ASSESSMENT COVERAGE

- ☐ Amount of coverage \$_____

This public document was promulgated at an annual cost of \$9,019.00, or \$.09 per copy to distribute information to the public.

Appendix I

CERTIFIED PUBLIC ACCOUNTANTS

HONOLULU, HAWAII 96814
TELEPHONE (808)

MEMBERS
AMERICAN INSTITUTE
OF CPA
HAWAII SOCIETY
OF CPA

AUDITORS' REPORT

Board of Directors
Association of Apartment Owners
of

We have examined the accompanying statement of cash receipts and disbursements and cash balances of the ASSOCIATION OF APARTMENT OWNERS OF (a Condominium) for the year ended December 31, 1987. Our examination was made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

As described in Note A, the Association's policy is to prepare its financial statement on the basis of cash receipts and disbursements; consequently, revenues are recognized when received rather than when earned, and expenses are recognized when paid rather than when the obligations are incurred. Accordingly, the accompanying financial statement is not intended to present financial position and results of operations in conformity with generally accepted accounting principles.

In our opinion, the financial statement referred to above presents fairly the cash receipts and disbursements and cash balances of the ASSOCIATION OF APARTMENT OWNERS OF (a Condominium) for the year ended December 31, 1987, on the basis of accounting described in Note A, which basis has been applied in a consistent manner with that of the preceding year.

Honolulu, Hawaii
March 3, 1988

Note: Portions of the Audit Report have been deleted for purposes of confidentiality.

ASSOCIATION OF APARTMENT OWNERS OF
(a Condominium)

STATEMENT OF CASH RECEIPTS AND DISBURSEMENTS AND CASH BALANCES

Year ended December 31, 1987

Cash receipts

Maintenance fees (Notes A and C)	\$1,143,770
Parking fees	51,129
Interest	15,485
Air conditioning fees (Notes A and C)	20,384
Motorola rental income	10,656
Storage room	6,239
Other	<u>17,246</u>
Total cash receipts	<u>1,264,909</u>

Cash disbursements

Building maintenance		
Salaries and wages-maintenance, security, and cleaning	\$ 276,941	
Major projects (Note D)	340,001	
Repairs and cleaning supplies	46,911	
Elevator	48,173	
Grounds	32,790	
Air conditioning-penthouse units	18,308	
Pump and ventilation	17,034	
Refuse	21,982	
Pool and lighting supplies	8,398	
Painting	<u>5,777</u>	816,315
Utilities		
Electricity	124,216	
Water	44,862	
Sewage services	37,561	
Telephone and communications	<u>14,806</u>	221,445
Insurance(all)	109,561	
Management and administrative salaries	91,853	
Payroll taxes	32,954	
Legal and audit fees	24,120	
Office supplies and outside services	22,794	
Employee allowances	14,064	
General excise & income taxes	8,602	
Other	<u>10,592</u>	
Total cash disbursements		<u>1,352,300</u>

Excess of cash disbursements over receipts (87,391)

Cash balances at beginning of year 323,971

Cash balances at end of year (Note B) \$ 236,580

See accompanying notes to financial statement.

ASSOCIATION OF APARTMENT OWNERS OF
(a Condominium)

NOTES TO FINANCIAL STATEMENT

December 31, 1987

NOTE A - METHOD OF ACCOUNTING

In accordance with industry practice, the financial statement of the Association of Apartments Owners of (a Condominium) is presented on the basis of cash receipts and disbursements; consequently, revenues are recognized when received rather than when earned, and expenses are recognized when paid rather than when the obligations are incurred. In addition to its cash balances, the Association had the following assets and (liabilities) at December 31, 1987:

Receivables, maintenance fees, air conditioning fees and other assessments	\$ 5,467
Prepaid insurance	1,987
Income tax refund	1,327
Unpaid operating expense	(32,364)
Unpaid insurance premiums	(77,482)
Liabilities for major projects	(88,968)
Security key deposits	(9,850)
Accrued expense	(327)
Maintenance fees, air conditioning fees and other assessments received in advance	(23,892)

All unpaid operating expenses and accrued taxes were subsequently paid during January and February 1988.

NOTE B - CASH BALANCES

The cash balances as of December 31, 1987 were comprised of the following:

Operating account	\$ 25,379
Major projects funds	188,013
Reserve for security key deposit	18,726
Air conditioner reserve	4,162
Petty cash	<u>300</u>
	<u>\$ 236,580</u>

NOTE C - MAINTENANCE AND AIR CONDITIONING FEES

Maintenance fees are paid by each apartment owner in order to maintain the common areas. Maintenance fees are assessed based on each apartment's respective common interest in the building as stated in the project's Declaration of Horizontal Property Regime. During 1987, the monthly aggregate maintenance fees were \$94,883.

ASSOCIATION OF APARTMENT OWNERS OF
(a Condominium)

NOTES TO FINANCIAL STATEMENT (Continued)

December 31, 1987

NOTE C - MAINTENANCE AND AIR CONDITIONING FEE (Continued)

Air conditioning fees are paid by each penthouse apartment owner for the electricity and equipment maintenance of the penthouse units' central air conditioning system. The monthly aggregate air conditioning fees charged were \$1,713 for 1987.

NOTE D - MAJOR PROJECTS

During 1987, the Association made the following expenditures on major projects:

Front entry renovation	\$ 186,324
Hallway ceilings	64,925
Code violations	24,699
Office renovation	17,524
Pool chairs	12,794
Building signs & graphics	11,418
Elevator controls	7,773
Tennis court resurfacing	4,363
Aloha room	3,498
Apartment 210 renovation	3,252
Others	<u>3,431</u>
	<u>\$ 340,001</u>

NOTE E - INCOME TAXES

For 1987, the Association has not elected to be treated as a tax-exempt condominium management association under the provisions of the Internal Revenue Services Code Section 528. Therefore, the Association has filed its Federal and State income tax returns in the same manner as corporate entities. There was an income tax liability of \$1,573 for 1987.

NOTE F - LEGAL ACTIONS

1. In June 1980, the Association filed a Complaint for Trespass (Encroachment) and for Mandatory Injunction, against

ASSOCIATION OF APARTMENT OWNERS OF
(a Condominium)

NOTES TO FINANCIAL STATEMENT (Continued)

December 31, 1987

NOTE F - LEGAL ACTIONS (Continued)

The Supreme Court's decision was final and disposes of the action. The Association has no exposure to loss on the action, other than attorneys' fees and costs incurred in prosecuting the case.

2. In June 1987, a Complaint was filed against the Association for alleged water damage to an apartment unit.
3. In July 1985, a Complaint was filed against the Association, alleging invasion of privacy, and unfair and deceptive trade practice.

Appendix J

ASSOCIATION OF APARTMENT OWNERS OF
(A Condominium)
FINANCIAL STATEMENTS
years ended December 31, 1987 and 1986

With
Report of Certified Public Accountant

Note: Portions of the Audit Report have been deleted for purposes of confidentiality.

CERTIFIED PUBLIC ACCOUNTANT

HONOLULU, HAWAII 96813

Telephone: (808)

Board of Directors
Association of Apartment Owners of

I have examined the accompanying statements of cash receipts and disbursements and of changes in cash balances of the Association of Apartment Owners of _____ for the years ended December 31, 1987 and 1986. My examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as I considered necessary in the circumstances.

As described in Note 1, the Association's policy is to prepare its financial statements on the basis of cash receipts and disbursements; consequently, certain revenues are recognized when received rather than when earned, and certain expenses are recognized when paid rather than when the obligation is incurred. Accordingly, the accompanying financial statements are not intended to present results of operations in conformity with generally accepted accounting principles.

In my opinion the statements mentioned above present fairly the cash receipts and disbursements, and the changes in cash balances of the Association of Apartment Owners of _____ for the years ended December 31, 1987 and 1986 in a manner consistent with that of the preceding year.

~~Hono~~lulu, Hawaii
February 2, 1988

STATEMENT OF CASH RECEIPTS AND DISBURSEMENTS
ASSOCIATION OF APARTMENT OWNERS OF

years ended December 31, 1987 and 1986

	1987	1986
CASH RECEIPTS:		
Maintenance fees	\$195,626	\$183,664
Interest	8,133	7,963
Legal fee reimbursements	534	1,007
Magnum, P.I.	1,000	0
Late charges	463	670
Total cash receipts	<u>\$205,756</u>	<u>\$193,304</u>
CASH DISBURSEMENTS:		
Improvements (Note 5)	\$11,046	\$13,975
Utilities:		
Electricity	\$5,091	\$5,597
Gas	604	526
Refuse	13,093	6,421
Water	12,711	11,711
total utilities	<u>31,499</u>	<u>24,255</u>
Maintenance and repair:		
Consulting	\$0	\$2,319
Custodial	1,763	5
Exterminating	6,507	1,170
General	5,932	5,866
Grounds	3,495	2,378
Lanais and supports	15,369	0
Paving	7,807	7,676
Payroll	29,559	23,325
Pool and recreation	2,558	2,835
Ropes and posts	0	5,554
Stairs and walkways	17,460	1,200
Vehicle	360	480
total maintenance and repair	<u>90,810</u>	<u>52,808</u>
Administration:		
Insurance - casualty	\$12,197	10,765
- payroll	7,771	13,253
Management	10,800	9,600
Office and communications	2,319	2,102
Other professional fees	790	5,378
Resident manager - payroll	13,052	11,427
Security (including payroll:	0	
1987-\$16,543, 1986-\$14,125)	17,036	15,600
Taxes - excise	363	340
- payroll	6,263	4,248
- income	1,045	1,339
Miscellaneous	2,807	766
total administration	<u>74,443</u>	<u>74,818</u>
Total cash disbursements	<u>207,798</u>	<u>165,856</u>
RECEIPTS IN EXCESS (SHORT) OF DISBURSEMENTS	<u>(\$2,042)</u>	<u>\$27,448</u>
	=====	=====

See also the accompanying Notes to Financial Statements

STATEMENT OF CHANGES IN CASH BALANCES
ASSOCIATION OF APARTMENT OWNERS OF

years ended December 31, 1987 and 1986

	Operating Fund	Reserve Fund	Total
Cash balances			
December 31, 1985	\$8,557	\$90,773	\$99,330
1986 excess of cash receipts over disbursements	27,448		27,448
Transfers from operating to reserve funds	(48,660)	48,660	0
Transfers from reserve to operating funds	18,108	(18,108)	0
Cash balances			
December 31, 1986	\$5,453	\$121,325	\$126,778
1987 excess of cash receipts over disbursements	(3,178)	1,136*	(2,042)
Transfers from operating to reserve funds	(45,072)	45,072	0
Transfers from reserve to operating funds	43,907	(43,907)	0
Cash balances			
December 31, 1987	\$1,110	\$123,626	\$124,736

* interest on reserve funds credited directly to reserves

See also the accompanying Notes to the Financial Statements

NOTES TO THE FINANCIAL STATEMENTS
ASSOCIATION OF APARTMENT OWNERS OF

years ended December 31, 1987 and 1986

1. Accounting Policies

is a 90 unit condominium located in Honolulu, Hawaii. The Association provides services and maintenance of common areas as required under the Hawaii Horizontal Property Regime Act. Its function is not intended to produce profits nor incur losses.

In accordance with industry practice, the Financial Statements of the Association of Apartment Owners of are presented on the basis of cash receipts and disbursements; consequently, certain revenues are recognized when received rather than when earned, and certain expenses are realized when paid rather than when the obligation is incurred. Physical assets, if any, are expensed as they are purchased and so do not appear on these statements.

Maintenance fees are paid monthly by each unit owner to the Association to maintain the common elements and pay common expenses. Maintenance fees increased 6% on January 1, 1988. Cash reserves are maintained to fund planned improvements, replacements and major repairs. The Association's receipts were collected and disbursements made by its agent.

2. Cash Balances

The cash of the Association at December 31 was invested as follows:

	<u>Yield %</u>	<u>1987</u>	<u>Yield %</u>	<u>1986</u>
Petty cash		\$100		\$100
Cash in checking		3,500	5.05	36,678
Money market certificates:				
1st Nationwide S&L	6.11	10,536	8.24	10,000
1st Nationwide S&L	6.35	20,600		
First Hawaiian Credit Corp	5.75	20,000	5.70	10,000
First Hawaiian Credit Corp	6.00	10,000	5.75	10,000
First Hawaiian Credit Corp	6.55	10,000	6.00	20,000
First Hawaiian Credit Corp	6.35	20,000		
3 First Hawaiian Credit Corp	6.50	30,000	6.00	40,000
Total		<u>\$124,736</u>		<u>\$126,778</u>
		=====		=====

3. Available Cash

Cash available for operations and reserves at December 31 was as follows:

	<u>1987</u>	<u>1986</u>
Cash balance, December 31	\$124,736	\$126,778
Plus:		
Maintenance fees receivable	817	2,531
(net of doubtful account 1987-\$956)		
Prepaid insurance	3,779	2,599
Due from Bank of Hawaii	368	0
Less:	<u>\$129,700</u>	<u>\$131,908</u>
Maintenance fees prepaid	5,689	3,064
Accounts payable	3,456	4,098
Income taxes payable	31	40
Available cash, December 31	<u>\$120,524</u>	<u>\$124,706</u>
	=====	=====

NOTES TO THE FINANCIAL STATEMENTS
(Concluded)
ASSOCIATION OF APARTMENT OWNERS OF
years ended December 31, 1987 and 1986

4. Income Taxes

Under current tax laws, a homeowners' association may file as a corporation or as a tax exempt organization. The Association chooses whichever election results in less tax. The Association has elected to file income tax returns as a corporation for the years ended December 31, 1987 and 1986. Under this election, interest and rents less related expenses were taxed at 15% for federal income taxes. Excess member assessments of \$14,144 were not taxed because they are being applied to reduce next year's assessments that would otherwise be due.

5. Improvements

These were as follows:

	1987	1986
	-----	-----
Gas grills		\$545
Lighting		11,576
Spa pump	\$3,333	
Office furniture	569	
Shut off valves	5,069	
Resident manager's apartment	1,842	
Tool shed	233	1,854
	-----	-----
total	\$11,046	\$13,975
	=====	=====