

**HANNA & VAN ATTA
ARTICLES OF INTEREST
AUGUST 2009**

We are pleased to provide articles and legal updates from time to time pertaining to the areas of our expertise, including real estate legal matters and matters pertaining to the legal aspects of common interest communities and homeowners and other owners associations. We will be updating and adding to these articles as new issues arise that we feel warrant your attention and concern.

We are providing three Legal Notes that we hope will be useful to our readership.

- **New FHA requirements - Mortgage Letter 2009-19**
- **HOA Assessments And Liens - Impact Of Financial Crisis In 2009**
- **California's Judicial Deference Rule for Common Interest Developments.**

David M. Van Atta and John Paul Hanna

New FHA requirements - Mortgage Letter 2009-19
By David M. Van Atta of Hanna & Van Atta

The Federal Housing Administration (FHA), a division of the Department of Housing and Urban Development (HUD), insures residential developers' construction loans and condominium mortgages. (See 12 U.S.C.A. §1715; 24 C.F.R. §§234.1 to 234.800.) The FHA also insures planned development loans under standard subdivision sections of the National Housing Act. (See 24 C.F.R. §§203.1 to 203.681.) The FHA requires that condominium projects be pre-approved. A developer who intends to meet FHA requirements must apply to the FHA regional office, obtain the necessary forms, and comply with FHA special procedures. In the current financial climate, obtaining FHA financing approval has become extremely important to developers as this provides the best opportunity of financing for potential buyers with less of a down payment and more favorable interest rates. However, under Mortgage Letter 2009-19, the methods and criteria for obtaining approvals for residential for sale condominium projects by FHA have been recently changed; some for the good and some for the worse. We are hopeful that FHA will make some changes to what has been provided in this Mortgage Letter, which goes into effect on October 1, 2009. If some changes are not made to the problematic matters that we review in the following discussion, FHA real estate lending may be difficult to obtain for California condominium projects

Revised FHA Condominium Approval Process - Mortgage Letter 2009-19.

Under Mortgage Letter 2009-19, dated June 12, 2009, the Federal Housing Administration (FHA) has implemented a new approval process for condominium projects to insure mortgages on individual units under Section 203(b) of the National Housing Act. FHA will now allow lenders the option to determine project eligibility, review project documentation, and certify to FHA compliance with Section 203(b) of the NHA and 24 CFR 203 of HUD's regulations. The requirements of this Mortgage Letter are effective for all case numbers assigned on or after October 1, 2009 except as noted in the Mortgage Letter.

Although Mortgage Letter 2009-19 has some provisions that will be beneficial to developers who are selling residences, several of the stated items will create problems, especially for California developers.

- In particular, as later discussed, the Mortgage Letter 2009-19 provides that no more than 30% of the units in a project can be encumbered with FHA insured loans.
- In addition, reserve studies for the condominium association to be provided to the lender must be no more than 12 months old. California law only requires such a reserve study every 3 years.

- Transfer of control of the homeowners association must pass to the owners of units within the project no later than the earlier of the following:
 1. 120 days after the date by which 75 percent of the units have been conveyed to the unit purchasers, or
 2. One year after completion of the project evidenced by the first conveyance to a unit purchaser.

This requirement is at odds with the manner in which association control is handled in California under the State of California's Department of Real Estate regulations. Projects whose documents currently comply with these State requirements will not comply with these new FHA requirements.

[Note: as is stated later in this article, this new criteria is a change from prior FHA policy which allowed longer time frames under Appendix 24, HUD Legal Policies]

- Condominium Project approvals will expire two years from the date the project has been placed on the FHA list of approved condominiums. After this two-year period has expired, the project will require recertification

One beneficial aspect of Mortgagee Letter 2009-19 is that the former one-year waiting period requirement for conversions will be eliminated for projects undergoing remodeling or rehabilitation. However, the entire condominium project, including the common facilities, must be 100 percent completely built before any mortgage in the project may be endorsed.

Another benefit of Mortgagee Letter 2009-19 is that it will permit pre-approval of new construction projects with certain conditions.

Under Mortgagee Letter 2009-19, a mortgage lender now has two options when processing a condominium project for loan approval with FHA. One option is for FHA to undertake the review and approval process as the HUD Review and Approval Process (HRAP). The other option is for the lender to directly undertake the review and approval process under the Direct Endorsement Lender Review and Approval Process (DELRAP) that is outlined in the Mortgagee Letter. This DELRAP option is only available to lenders who have unconditional "Direct Endorsement" authority and staff with knowledge and expertise in reviewing and approving condominium projects. The processing options stated above will be applicable to condominium developments that are: (1) Proposed/Under Construction; (2) Existing Construction; or (3) Conversions.

The following are listed as ineligible projects: (A) Condominium Hotels; (B) Timeshares or segmented ownership projects, (C) Houseboat projects; (D) Multi-dwelling unit condominiums [i.e. more than one dwelling per condominium unit] and (E) all projects not deemed to be used primarily as residential. (This last category bears some analysis as to what is not being used primarily for residential; bringing to issue so called "live-work" loft projects.)

Note: Special provisions are made for "Site Condominiums", being defined as "single family detached dwellings encumbered by a declaration of condominium covenants or condominium form of ownership." Under the Mortgagee Letter, FHA Condominium Project approval is not required for Site Condominiums (being treated essentially as planned development lots); however, the Condominium Rider (Attachment D to Mortgagee Letter) must be submitted for insurance endorsement. Manufactured housing condominium projects (MHCPs) may not be processed as Site Condominiums; these projects will require approval under HRAP.

Note that under Mortgagee Letter 2009-19, the Spot Loan Approval process previously used by FHA, as defined in Mortgagee Letter 1996-41, has been eliminated.

There are also specific criteria regarding environmental review stated in Mortgagee Letter 2009-19.

Project Eligibility Requirements

Mortgagee Letter 2009-19 provides the following list of “Project Eligibility Requirements”:

- Projects must be covered by hazard and liability insurance and, when applicable, flood insurance.
- Right of first refusal is permitted unless it violates discriminatory conduct under the Fair Housing Act regulation in 24 CFR 100.
- 25 percent maximum floor area of a project can be used for commercial purposes of a nature that is homogenous with residential use.
- No more than 10 percent of the units may be owned by one investor. [For two and three unit condominium projects, no single entity may own more than one unit within the project; all units, common elements, and facilities within the project must be 100 percent complete; and only one unit can be conveyed to non-owner occupants.]
- No more than 15 percent of the total units can be in arrears (more than 30 days past due) of their condominium association fee payment.
- At least 50 percent of the total units must be sold prior to endorsement of any mortgage on a unit. Valid presales include an executed sales agreement and evidence that a lender is willing to make the loan.
- At least 50 percent of the units of a project must be owner-occupied or sold to owners who intend to occupy the units.
- Legal Phasing is permitted. For purposes of calculating the owner-occupancy percentage:
 - a. On multi-phased projects the owner-occupancy percentage is calculated on the first declared phase and cumulatively on subsequent phases if the ownership of the condominium project remains the same;
 - b. If multi-phasing includes separate ownership per phase, each phase is calculated individually; or
 - c. Single-phase condominium project approval requests must meet the owner-occupancy percentage requirement.
- FHA Concentration
 - a. Projects consisting of three or fewer units will have no more than one unit encumbered with FHA insurance.
 - b. Projects consisting of four or more units will have no more than 30 percent of the total units encumbered with FHA insurance.
- Reserve Study - a current reserve study must be provided that is no more than 12 months old.

Manufactured Housing Condominium Projects (MHCPs) are now eligible for FHA mortgage insurance subject to specific requirements stated in Mortgagee Letter 2009-19. Such MHCPs may not be processed as site condominiums; these projects will require approval under HRAP.

Condominium Conversions. Mortgagee Letter 2009-19 makes changes to condominium conversion requirements are: The one-year waiting period requirement for conversions is eliminated for projects undergoing remodeling or rehabilitation, the entire condominium project, including the common facilities, must be 100 percent completely built before any mortgage may be endorsed.

Condominium New Construction Pre-approval and Inspection Requirements. Mortgagee Letter 2009-19 now permits pre-approval of new construction projects with certain conditions.

General Processing Steps. Mortgagee Letter 2009-19 states numerous **General Processing Steps for DELRAP or HRAP:**

- A. Determine acceptability of the site and location of the project. Refer to Attachment A, *Condominium Project Approval Matrix*.
- B. Review the project's financial and legal documents; if acceptable, authorized personnel will sign and date the Lender Certification of Condominium Requirements (Attachment B).

C. Place the Lender Certification of Condominium Requirements and other required certifications in the FHA case binder.

D. Retain and maintain all documents used to review and approve the project for a period of three years from the date of project approval.

E. Mixed condominium review and processing is not permitted. If a lender opts to participate in the DELRAP process, all future processing submissions must be processed, accordingly, except for manufactured housing condominium project approvals.

F. If a project is listed as Rejected or Withdrawn on the FHA-approved condominiums list, the only approval process accepted is HRAP.

G. Second and subsequent lenders that submit a unit for insurance in a project that is listed on the FHA-approved condominium list are not required to complete any further approval process. At the lender's discretion, they may seek any additional information to satisfy their own requirements and/or perform their own due diligence. FHA will require the lender to certify it has no knowledge of circumstances or conditions that might have an adverse effect on the project or cause a mortgage secured by a unit in the project to become delinquent,

H. Subsequent phases being approved by a different lender must follow the same general procedures. The original lender must also follow these general procedures but will have already satisfied some of the steps listed.

I. All required certifications, as applicable, must be included in the FHA case binder submitted for insurance endorsement. (Insurance rider [Attachment D] provides to so long as the association maintains insurance coverage as the lender requires, the lender waives the requirement for monthly payment of 1/12th of annual insurance premiums; borrower to pay assessments when due.)

J. For both new construction and conversions if the developer intends to market five or more units within the next 12 months with FHA mortgage insurance, an Affirmative Fair Housing Marketing Plan (AFHMP) or a Voluntary Affirmative Marketing Agreement (VAMA) must be in place. Form HUD-935.2C, Affirmative Fair Housing Marketing Plan — Condominium or Cooperatives, is to be used for condominium projects.

K. Environmental reviews will be required for proposed and under construction project approvals submitted under the HRAP option consistent with the Environmental Review Requirements listed in Section IV. D. Environmental review is not required under DELRAP, but the lender must take necessary actions to avoid or mitigate identified environmental conditions prior to completing its project review.

L. Transfer of control of the Homeowners Association shall pass to the owners of units within the project no later than the earlier of the following:

1. 120 days after the date by which 75 percent of the units have been conveyed to the unit purchasers, or

2. One year after completion of the project evidenced by the first conveyance to a unit purchaser. [Note: this is a change from prior FHA policy which allowed longer time frames under Appendix 24, HUD Legal Policies]

As noted above, this requirement will prove to be problematic for most California projects, as the legal documents for such projects that have been imposed prior to the date of the Mortgagee Letter will in all likelihood not comply, since the California legal requirements under the Department of Real Regulations allows such transfer of control to occur within two years, not one year, for single phase projects, and up to four years for multiple phase projects.

Certification for Initial Approval. Lenders must provide certifications on company letterhead signed by a company authorized representative (signature stamps or electronic signatures are not authorized) that: (1) The eligible condominium project complies with applicable FHA requirements addressed within this Mortgagee Letter; (2) All condominium legal documents meet HUD regulations, state and local condominium laws; and (3) Pre-sale and owner occupancy ratios per loan are met. NOTE: FHA will not require an attorney's certification; however, lenders may obtain this as part of their due diligence process. This document will not replace other condominium certifications required from the lender.

Certification of Approved Projects. If a project has been previously approved, lenders must certify that they are not aware of any change in circumstances since initial approval of the project that would result in the project no longer complying with FHA requirements.

Recertification of Project Approvals. Condominium Project approvals expire two years from the date the project has been placed on the list of approved condominiums. This also applies to all projects currently on the list of approved condominiums. After this two-year period has expired, the project will require recertification to determine that the project complies with HUD's owner-occupancy requirement and that no conditions currently exist which would present an unacceptable risk to FHA. Items that should be given consideration are:

1. Pending special assessments,
2. Pending legal action against the condominium association, or its officers or directors,
3. Hazard, liability insurance and when applicable flood insurance.

Attorney Opinions. Previous to Mortgagee Letter 2009-19, FHA required an attorney's certification that the legal documents meet HUD's requirements. The attorney's opinion letter should comply with Appendix 24, HUD Legal Policies, to see that the legal documents do meet HUD requirements. FHA no longer requires an opinion letter, but we believe that most lenders who will undertake any certifications will require some sort of opinion that the documents meet the HUD requirements.

Project Documentation: Notwithstanding the recent liberalization by Freddie Mac (FHLMC) and Fannie Mae (FNMA) of the requirements for financing by those institutions of residential condominium projects, FHA/HUD still adheres to the HUD legal policies set forth in HUD Appendix 24, the December 1980 version. Documents that comply with FNMA and FHLMC standards may not meet the standards of Appendix 24. Project legal documents that comply with the current recently revised FHLMC and FNMA requirements may not comply with all of the Appendix 24 requirements. These documents may have to be amended to enable the project to qualify for project approval by FHA.

Working Capital: HUD requires that arrangements be made in the project documentation for establishing a working capital reserve in the amount of 2 months of the project's assessments for each unit in the project. This is not required by either FNMA or FHLMC. See HUD Revised Legal Policy attached to Appendix 24 of HUD Handbook 4265.1 (subparagraph (2) of subparagraph (d) of Section 7) reading:

"There shall be established an adequate reserve fund for the periodic maintenance, repair and replacement of the common elements, which fund shall be maintained out of regular assessments for common expenses. Additionally, a working capital fund must be established for the initial months of the project operations equal to at least a two months' estimated common area charge for each unit." (HUD Revised Legal Policy attached to Appendix 24 of HUD Handbook 4265.1, Section 7. Owners Association's Rights And Restrictions, (d) Assessments, (2) Reserves and Working Capital)

As of this writing there is confusion as to how to prepare project legal documentation that will comply with this provision. As FHA guidelines for loan amounts that will qualify for FHA funding have been raised considerably in the past few years, from 2007 through 2009, projects that did not previously qualify for FHA financing may now qualify. However, the project legal

documentation may not have anticipated FHA financing, providing only for the legal requirements of FNMA and FHLMC. This would not include provisions for the FHA required working capital fund. Until recently, as of early 2009, FHA required that project documentation be amended to provide for the FHA requirement of the working capital fund. However, it appears that FHA has now administratively changed this procedure: FHA will not require that the legal documents be amended for the working capital fund, but *will still* require evidence that each unit in the project pay the amount required for the working capital fund, meaning the equivalent of two months of regular assessments. [There is a problem inherent in this situation if the developer has already closed some units using conventional {non-FHA} financing. The developer may have to fund the extra two months assessments for the units that have already been closed and pay those funds to the association. This working capital fund is in addition to the regular monthly assessments, and FHA's position is that funds already paid into the association as regular assessments cannot be counted as contributing to this working capital fund. Note that the manner used by a developer to handle arrangements for funding the FHA capital fund may result in issues being raised by the California Department of Real Estate ("DRE") as to assuring the DRE that the developer will pay its share of such funds.

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HOA ASSESSMENTS AND LIENS - IMPACT OF FINANCIAL CRISIS IN 2009

By David M. Van Atta and John Paul Hanna

Various real estate projects and properties are set up as "common interest developments" to use the parlance that is established under California law. These projects can be residential developments, commercial developments and/or mixed use developments.

Common to most of these developments, in one form or another, is the operation of such a project by an owners association established under a declaration of covenants, conditions and restrictions (commonly the "CC&R's). The CC&R's often provide for assessments to be levied against the lots, parcels or units of the development for allocation of a share of the project's common maintenance costs and expenses that are incurred by the Association to the various lots, parcel or other interests, such as condominium interests. The CC&R's often provide that these assessments can be enforced by the association by lien rights stated in the CC&R's and as provided under applicable law.

However, lenders and the secondary mortgage market providers, such as Freddie Mac and Fannie Mae, and FHA, often require language that subordinates the association's lien rights to the lender's loan. This is sometimes limited to first position loans [loans of first priority], but not always. (In some instances, this subordination, or "priming" of the association assessments is not total. Freddie Mac allows for up to 6 months assessments of a homeowners association for a condominium project to remain ahead of the first mortgage.)

With the current state of the real estate financial and business market as of this writing being somewhat dire, the question arises as to what is the impact on a real estate development, and the individual lots, parcels or units in that development when foreclosures occur and the association's assessment liens and collection rights are impaired or limited by the lender's lender protection provisions?

The context of our review deals with different possible scenarios:

- one is where a project developer has sold off portions of a project under development, and then fails as to the balance of the project, leaving the development or construction lender exposed.

- Another lender issue is the lender who made a “takeout” loan, or perhaps many takeout loans, to residence purchasers who have then defaulted.

When a real estate project is “troubled” the lender considers whether or not to foreclose. One issue the lender faces is if there are any obligations or liens that will continue as obligations after the foreclosure, such as tax liens, mechanics liens, prior mortgage liens, and, perhaps, owners association liens.

When a project is documented as a common interest development, lenders look for provisions that protect their lien positions and priority. These are often called “lender protection” provisions. At a minimum the lender wants language that stipulates that no action under the project’s legal management documents, the declaration of covenants, conditions and restrictions, or CC&R’s, will impair the lender’s lien. However, most project legal documents, particularly for residential condominium developments, go further and contain provisions dealing with lender’s rights, such as rights of the lender to assert the developer’s rights as the project’s declarant, as well as rights for the lenders to vote on various association matters, and rights of lenders to veto or participate in amendments to project documents.

Very often the lender protection provisions contain language that stipulates that the delinquent association assessments of the developer or of unit or lot owners will not be an obligation of the lender that obtains title by foreclosure or by deed in lieu of foreclosure, and that any lien imposed for such delinquent assessments will not be prior to the lender’s lien; therefore the lender’s foreclosure, figuratively “wipes out” the lien for the unpaid assessments. (As stated above under current Fannie Mae and Freddie Mac requirements, lenders must obtain priority over assessments that are more than 6 months delinquent, but can be subjected to up to six months of delinquent assessments.)

Where there are massive foreclosures by lenders in a project, the results of the application of this lender protection verbiage can be catastrophic. Those lot or unit owners who have honored their financial obligation to the owners association are now saddled with a major portion of the unpaid costs incurred because of the delinquent owners or a delinquent developer. However, in reality the lender or lenders are not truly getting away from the entire burden. The unpaid obligation will have to be spread or reallocated against all of the ownerships, including those taken back by the lender or lenders. The assumption is that the unpaid costs have now piled up and the association will need the revenue to pay its bills and to put funds in its coffers to cover unfunded reserves and other unpaid costs. Once the lender takes title to the foreclosed lots or units, those lots or units will be subject to this reallocation. The lender may escape some of the unfunded costs, but not all, as the association reallocates the losses.

But the losses are greater, or could be greater than just those monetary losses. If the lender or lenders do not honor the financial obligations, the value of their collateral is going to erode. The assessments are generally for common area maintenance responsibilities, such as landscaping, road maintenance, exterior residence maintenance, maintenance and operation of commonly used facilities. In addition for many common interest projects, particularly condominiums and townhome planned development projects, the common assessments pay for the insurance obligations of the association which includes casualty coverage for the structures and infrastructure of the project. Where a common interest development is in a precarious financial condition, the funding of insurance policies may not be adequately covered. The lender’s collateral is at risk.

When lenders face these issues, there needs to be awareness as to what are going to be the next steps in the life of the collateral. If the lender forecloses or takes title to the real estate collateral, the collateral cannot be allowed to erode physically, but also unfunded costs are going to be part of the day of reckoning when the asset is sold off. Parties who acquire this collateral are going to look for unfunded short fall obligations. This will have a negative impact on what the lender will be able to obtain as it attempts to market or remarket these assets.

One thing that lenders do is to delay, by not foreclosing and taking title. Title still remains in the delinquent owners or developers and the situation just gets worse over time. Institutional paralysis seems to have become an epidemic of no small proportions. There appears to be an unwillingness to recognize the reality that these types of real estate projects need the revenue of assessments to keep the collateral viable.

Lenders need to do a better job of monitoring the status of these aspects of the developments on which they funded development loans. As there may have been tax reserves in the loan, there should be reserves for payment of association assessments.

Ultimately the lender will pay the price, being that the collateral will deteriorate and the price paid by “white knights” or “vulture funds” in the market to acquire distressed assets will discount the assets when there are material unfunded or under funded obligations.

Lenders who foreclose on distressed project have concerns about the operation of the project, but have to be careful not to assume liability for the transgressions of the defaulted developer. There is a balancing act that must be performed. Lenders will want to avoid being cast into the shoes of the defaulting developer, with concerns about construction defect liability and liability for the developer’s marketing representations or misrepresentations. It is imperative that the lender develop an effective pre-foreclosure strategy before it begins foreclosure on common interest developments. There are many other issues involved, with the payment and collection of assessments being just one.

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**California’s Judicial Deference Rule for Common Interest Developments.
By David M. Van Atta and John Paul Hanna of Hanna & Van Atta**

The boards of directors of community associations that operate and manage common interest developments, such as condominium projects, planned developments and stock cooperatives, must be aware of the scope of their decision making and the role of the courts with respect to judicial review of those decisions. Generally the courts are to defer to the decisions made by a board of directors. This is commonly referred to as “judicial deference.”

Addressing the extent of judicial review of decisions made by boards of directors of common interest development associations in California, the California Supreme Court declined to adopt the “business judgment rule” generally used in the corporate setting. Instead the California Supreme Court when addressing the issue of the extent of judicial review of the actions of a community association board adopted a “judicial deference” rule or standard. (*Lamden v. La Jolla Shores Clubdominium Homeowners Assn.*, 21 Cal. 4th 249, 87 Cal. Rptr. 2d 237, 980 P.2d 940 (1999).)

The Court found that the “business judgment rule” does not directly apply to legal challenges to decisions made by community association boards of directors. Instead, in *Lamden*, the Court fashioned a rule of judicial deference applicable to community association board decision making that applies regardless of an association’s corporate status, when owners in common interest developments seek to litigate ordinary decisions entrusted to the discretion of their associations’ boards of directors.

The Court explained the rule of judicial deference as follows: "Where a duly constituted community association board, upon reasonable investigation, in good faith and with regard for the best interests of the community association and its members, exercises discretion within the scope of its authority under relevant statutes, covenants and restrictions to select among means

for discharging an obligation to maintain and repair a development's common areas, courts should defer to the board's authority and presumed expertise."

With respect to enforcing the project's governing documents, the California appellate courts have determined that an association has discretion to select among the means for remedying a violation of the recorded covenants without resorting to expensive and time-consuming litigation, and the courts should defer to the exercise of discretion by Boards of Directors. The association has the right, but not necessarily the obligation, to file lawsuits against owners for violating the covenants. *Haley v. Casa Del Rey Homeowners Ass'n* 153 Cal.App.4th 863, 63 Cal.Rptr.3d 514 (4th Dist., 2007); see *Hanna & Van Atta, California Common Interest Developments*, §22:88 (discussion of duty to enforce restrictions; hereinafter "Hanna & Van Atta")

Recently, a California appellate court stated that the judicial deference rule does not apply to acts that are beyond the authority of the Board of Directors under the governing documents. A Board decision that is inconsistent with the plain meaning of the governing documents is not entitled to judicial deference. (*Ekstrom v. Marquesa at Monarch Beach Homeowners Ass'n*, 168 Cal.App.4th 1111, 86 Cal.Rptr.3d 145 (4th Dist., 2008); but see, *Ritter & Ritter, Inc. v. Churchill Condominium Ass'n*, 166 Cal.App.4th 103, 82 Cal.Rptr.3d 389 (2d Dist., 2008) ("*Ritter*") for discussion of limitations on applications of the *Lamden* judicial deference doctrine.)ⁱ

In addition, in the recent *Ritter* case, the court of appeals distinguished between the business judgment rule stated in Corporations Code section 7231 as applied to the personal liability of directors and the "judicial deference rule" as applied to the decision making of directors expressed in *Lamden*. In *Ritter*, the appellate court stated that it had no problem with the trial court finding that the association was liable for breaching its obligations and that the trial court was not required to give judicial deference to the board's determinations on behalf of the association under *Lamden* and yet not find personal liability for the board members' actions under Corporations Code section 7231.

In discussing *Lamden*, the appellate court in *Ritter* stated:

However, the Supreme Court adopted a rule it termed as analogous to the business judgment rule: "where a duly constituted community association board, upon reasonable investigation, in good faith and with regard for the best interests of the community association and its members, exercises discretion within the scope of its authority under relevant statutes, covenants and restrictions to select among means for discharging an obligation to maintain and repair a development's common areas, courts should defer to the board's authority and presumed expertise." (*Lamden, supra*, 21 Cal.4th at p. 265, 87 Cal.Rptr.2d 237, 980 P.2d 940.) The Supreme Court adopted the association's position, at least as far as ordinary managerial decisions are concerned: "Common sense suggests that judicial deference in such cases as this is appropriate, in view of the relative competence, over that of courts, possessed by owners and directors of common interest developments to make the detailed and peculiar economic decisions necessary in the maintenance of those developments." (*Id.*, at pp. 270-71, 87 Cal.Rptr.2d 237, 980 P.2d 940.)

The *Lamden* decision was restricted to "ordinary" decisions involving repair and maintenance actions that were clearly "within the board's discretion under the development's governing instruments." The case gives no direction as to what standards courts should apply when faced with a challenge to a board action involving an extraordinary situation (e.g., major damage from an earthquake) or one not pertaining to repair and maintenance actions, e.g., a decision to deny approval to an improvement project desired by an owner." (Sproul & Rosenberry, *Advising California Condominium and Homeowners Associations* (Cont.Ed.Bar May 2002 Update) § 2:16, pg. 23.) The *Lamden* court also noted that the rule of judicial deference to board decision-making can be limited in certain circumstances; (e.g. by the association's governing documents, when the association has failed to enforce the provisions of the CC & R's.) (See also, *Nahrstedt v. Lakeside Village Condominium Assn.* (1994) 8 Cal.4th 361, 33 Cal.Rptr.2d

63, 878 P.2d 1275; *Dolan-King v. Rancho Santa Fe Assn.* (2000) 81 Cal.App.4th 965, 97 Cal.Rptr.2d 280; *DeBaun v. First W. Bank & Trust Co.* (1975) 46 Cal.App.3d 686, 120 Cal.Rptr. 354.)

Ritter & Ritter, Inc. v. Churchill Condominium Ass'n, 166 Cal.App.4th 103, 82 Cal.Rptr.3d 389 (2d Dist., 2008); see *Hanna & Van Atta* §18:58 (discussion of duties of directors and the business judgment rule.)

Where the recorded CC&Rs of a condominium project specifically authorized the Board of Directors to permit an owner to exclusively use portions of the common area that were nominal in area and adjacent to the owner's unit, if the use did not unreasonably interfere with other owners' use and enjoyment of the project, the Board's decision to allow the use of common area attic space for storage purposes was entitled to judicial deference, and the use was permissible. (*Harvey v. Landing Homeowners Ass'n*, 162 Cal. App. 4th 809, 76 Cal. Rptr. 3d 41 (4th Dist. 2008).)

The rule of judicial deference to good faith decisions of homeowner association boards is an affirmative defense, and is waived if not raised by the association in the trial court. (*Ekstrom v. Marquesa at Monarch Beach Homeowners Ass'n*, 168 Cal.App.4th 1111, 86 Cal.Rptr.3d 145 (4th Dist., 2008).)

Therefore, association boards of directors should exercise a degree of caution when electing to take action or not take action in the administration of the association's affairs on behalf of its members. The judicial deference rule provides a degree of comfort to association boards, but does not eliminate judicial scrutiny. The keys to the determination, based on the *Lamden* decision as augmented by the *Ekstrom* decision, are:

1. There is a duly constituted community association board;
2. The board conducts reasonable investigation;
3. The board acts in good faith;
4. The board acts for the best interests of the community association and its members;
5. The board exercises discretion within the scope of its authority under relevant statutes, covenants and restrictions to select among means for discharging its obligations.
6. The action taken is not beyond the authority of the Board under the governing documents.

ⁱ The Court in *Ekstrom* stated: "We disagree the new rules are entitled to judicial deference under *Lamden*. As with the Board's prior policy that palm trees are exempt from the CC & Rs, the new rules are in direct conflict with the CC & Rs. The rules specifically exclude all palm trees planted before 2006- which basically means all trees that might currently obscure the Plaintiffs' views. But section 7.18 does not grant the Association discretion to exclude view-blocking trees, it only gives the ARC discretion to determine whether or not a particular tree blocks a view. Furthermore, the new rules established what might best be called a "bowling alley" definition of what constituted view. Even if the Board had some discretionary authority to define what was meant by view, it was not free to fashion a definition that rendered section 7.18 meaningless. (See *Nahrstedt v. Lakeside Village Condominium Assn.* (1994) 8 Cal.4th 361, 380-381, 33 Cal.Rptr.2d 63, 878 P.2d 1275 [CC & Rs to be interpreted according to rules of contracts with view toward enforcing reasonable intent of parties].)"

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