COLORADO LEGISLATIVE ACTION COMMITTEE
community
ASSOCIATIONS INSTITUTE

2014 End of Session Report

As CAI's Colorado Legislative Action Committee (CLAC) was planning for the 2014 legislative session in Colorado, we were told by the sponsors of the 2013 HOA Reform Package that they anticipated a quiet 2014 session for HOAs. Since five HOA bills were signed into law in 2013, key legislators were committed to see how implementation of those bills went before determining whether any further legislation regulating associations was necessary. The sponsors of the HOA Reform Package stuck to their word. However, a handful of other legislators had a different approach.

During the 2014 session, five bills were introduced which would have directly impacted HOAs. Of those bills, only two made it through the legislative process and were signed into law. A synopsis of the bills that passed and those that did not pass are outlined below.

HOA Records-On January 15, 2014, Representative Diane Mitsch Bush (D-Steamboat Springs) introduced House Bill 14-1125 (HB 1125) in the Colorado House of Representatives. Senator David Balmer (R-Centennial), at the request of CLAC, sponsored the bill in the Senate. The purpose of HB 1125 was to fix an inadvertent oversight in the association records law which was overhauled during the 2013 legislative session. At the time HB 1125 was introduced, CCIOA prohibited associations from publishing the telephone numbers and email addresses of members. Obviously, this statutory prohibition limited the information which associations could include in their membership directors.

HB 1125 easily made it through the legislative process and was signed into law by Governor Hickenlooper on March 27th. HB 1125 went into effect on August 6, 2014 and permits an association to publish email addresses and telephone numbers of members and residents of the association, if those members or residents first provide written consent to their association to publish this information. Owners and residents may withdraw this written consent, but such withdrawal of consent does not require their association to go back and "change, retrieve or destroy" previously published telephone numbers or email addresses. Also, the bill permits owners and residents to electronically provide or withdraw their consent to their associations.

The LAC worked with Representative Mitsch Bush in drafting HB 1125 and the LAC believes it's an excellent fix to an inadvertent oversight in the HOA records law.

Management Company Transparency-Prior to the 2014 legislative session beginning, the LAC informed by Representative Jeanne Labuda (D-Denver) that she intended to introduce a bill which would cap at $50 (or possibly even prohibit) transfer fees which management companies charge for the work they perform relative to the sale of units in an associations they manage. Based upon an impressive response by CAI members to a Call to Action from CLAC, Representative Labuda agreed to not cap such transfer fees. Instead, CLAC worked with Representative Labuda to introduce a bill to promote management company transparency. At our request, Senator David Balmer (R-Centennial) agreed to sponsor the bill in the Senate and was pivotal in ensuring that the bill was not amended to cap the fees which management companies charge.

On April 18, Governor Hickenlooper signed HB 1254 into law. The bill requires the disclosure of fees charged to HOAs in Colorado by management companies. HB 1254 will go into effect on January 1, 2015. Here's what you need to know about the bill:

1. it requires managers and management companies to disclose their fees and charges to associations during contract negotiations and on a yearly basis thereafter;
2. these fees and charges must be disclosed as part of the written management contract in order to be enforceable;
3. to be enforceable, the transfer fees which management companies charge relative to the conveyance of a home in an HOA must be disclosed in the management contract or specified on a line item in the real estate closing settlement statement; and
4. management companies must also disclose any other remuneration the company or any subsidiary, affiliate, or related person or entity receives that is in any way connected to its relationship with the HOA.

Managers and management companies who fail to make these disclosures would be subject to investigation and discipline by the Division of Real Estate.

Construction Defects-With one week remaining in the 2014 legislative session, SB 220 was introduced in the Colorado Senate. While at the time it seemed to some that this bill was introduced too late in the session to have any chance of passage, with relaxed rules in place for the end of the session, a bill can technically make it through the entire legislative process in three days. This bill was assigned to the Senate State, Veterans & Military Affairs Committee and the Senate Judiciary Committee.

Sponsored by Senator Jesse Ulibarri (D-Commerce City) and Senator Mark Scheffel (R-Parker), the bill sought to spur the construction of condominiums in Colorado. Unfortunately, the bill was so extreme that it would have guaranteed that owners of homes in HOAs would have no recourse against builders for defective construction. The bill was killed when the Senate Judiciary refused to take the bill up at the 11thhour.

As introduced, here's what the bill provided:

HOAs are not permitted to remove or amend mandatory arbitration provisions placed in declarations by developers.

The language of the bill says that a requirement within the declaration to mediate or arbitrate "represents a commitment on the part of the unit owners and the association on which a developer, contractor, architect, or other person involved with construction is entitled to rely." This choice of language is interesting; these mandatory arbitration provisions are placed in declarations unilaterally by developers and the homeowners have no ability to negotiate whether arbitration is an appropriate alternative to a jury trial.

Unless the association can prove that the arbitration provider is unqualified, construction defect claims must be resolved by the arbitration service provider named in the declaration by the developer.

It is not unusual for developers to require the use of arbitration service providers who are known for providing low awards for construction defects. This results in a very one-sided arbitration process and provides HOAs with no ability to participate in choosing the individuals who will sit on the arbitration panel. Further, in addition to the strong likelihood that the arbitration award for the defects will be much lower than a verdict from a jury, the association's responsibility for the costs of the arbitration panel are taken off the top of the award for the defects. Taken together, this means an association victimized by defects will not be awarded enough money to make the required repairs.

Regardless of what is required in the declaration, the arbitrator must be a neutral third-party as described by Colorado law.

Colorado law provides that an arbitrator "who has a known, direct, and material interest in the outcome of the arbitration proceeding or a known, existing, and substantial relationship with a party may not serve as an arbitrator if the agreement requires the arbitrator to be neutral." This added requirement in the bill provides slim consolation because there is no "agreement" between the HOA and developer that the arbitrator must be neutral. In addition, it is highly unlikely that arbitration panels would be found not to be neutral, even when they are known for providing low awards to HOAs for construction defect claims.

If an HOA intends to institute any legal action (which would include proceeding to arbitration) for construction defects, the association would be required to prepare and provide the following disclosures to owners without the assistance of construction defect counsel:

- The expenses and fees that the board anticipates will be incurred, directly or indirectly, in prosecuting the action, including:
- Attorney fees, consultant fees, expert witness fees, and court costs, whether incurred by the association directly or for which it may be liable if it is not the prevailing party or that the association will be required, pursuant to an agreement with its attorney or otherwise, to pay if it elects not to proceed with the claim;
- The impact on the value of the units that are the subject of the action, both during the pendency of the litigation and after its resolution;
- The impact on the marketability of units that are not the subject of the action, including the impact on the ability of owners to refinance and buyers to get financing, both during the pendency of the litigation and after its resolution;
- The manner in which the association proposes to fund the cost of the litigation, including any proposed special assessments or use of reserves; and
- The anticipated duration of the litigation and the likelihood of success.

Without the assistance of construction defect counsel, how could an association possibly answer these questions and provide owners with meaningful disclosures? In addition, without first going through the initial phases of testing and working through the Notice of Claims process with the developer, it would be impossible for the association to provide meaningful notice on many of these issues. Frankly, these disclosure requirements set boards up for breach of fiduciary duty lawsuits.

The mandatory disclosures outlined above must be provided to owners at least 60 days before the HOA is permitted to provide notice of potential claims to developers as required by the Construction Defect Action Reform Act (CDARA).

If the defects were discovered late, the timing of these disclosures could result in an association not complying with applicable statutes of limitations and repose. This means that the association would be barred from pursuing construction defect claims against the developer.

The disclosures outlined above must also be provided to owners before an HOA hires any experts or consultants or incurs or agrees to pay expert fees or consultant fees in connection with the construction defects.

It is impossible to comply with some of the required disclosures without first obtaining the input from experts and consultants. Not only would it be virtually impossible for a board that does not have construction background to advise the board as to the nature of defects, but without their help, how could an association possibly provide a disclosure regarding the costs of consultation fees, expert witness fees, and the likelihood of success against the developer?

Associations are not permitted to pursue developers for construction defects unless the association obtains written consents from owners holding at least a majority of the total voting rights in the association. This consent must be obtained directly from the owners and proxies are not permitted to be utilized.

Obviously, it's extremely challenging to obtain written consents in associations. This is magnified when attempting to obtain written consents from 51% of owners in large scale communities, mountain communities where owners literally can live all over the nation and the world, and communities that are largely made up of individuals in the military who may be deployed. In a recent case, the Court of Appeals held that if an association seeks an amendment by written consent, it must comply with the Nonprofit Act requirement that such consents be obtained within 60 days. This provision alone will make it impossible for many HOAs to ever pursue construction defect claims against developers.

Every purchase and sales contract for a home in an HOA must include the following disclosure in bold-faced type:

The property is located within a common interest community and is subject to the declaration for such community. The owner of the property will be required to be a member of the owner's association for the community and will be subject to the bylaws and rules and regulations of the association. The declaration, bylaws, and rules and regulations will impose financial obligations upon the owner of the property, including an obligation to pay assessments of the association. If the owner does not pay these assessments, the association could place a lien on the property and possibly sell it to pay the debt. The declaration, bylaws and rules and regulations of the community may prohibit the owner from making changes to the property without an architectural review by the association (or a committee of the association) and the approval of the association. The declaration for the community or the bylaws or rules and regulations of the association may require that certain disputes be resolved by mandatory, binding arbitration. Purchasers of property within the common interest community should investigate the financial obligations of members of the association. Purchasers should carefully read the declaration for the community and the bylaws and rules and regulations of the association.

While this disclosure is not objectionable, we all know that purchasers of new homes rarely read these types of disclosures.

When taking all of these provisions together, it became abundantly clear that this bill would successfully strip away all rights of homeowners living in HOAs from being able to hold developers responsible for their construction defects. This means that homeowners would have been left paying the tab to repair such defects through special assessments or significant assessment increases. Without taking these difficult financial steps, the defects would go unrepaired and owners would be required to disclose the defects as part of any sales transaction, which disclosure would likely negatively impact property values.

While SB 220 was killed during the 2014 legislative session, the LAC expects construction defects to be a focus during the 2015 legislative session.

Taxation of Residential Storage Condominium Units-In addition to the construction defects bill, two other bills that would have impacted associations were both filled during the legislative session.

HB 1143 was introduced to address how storage condominium units are taxed. According to the bill, residential real property is taxed at 7.96% while commercial property is tax at 29%. As a result, the bill makes it possible to classify storage condominium units which are utilized for residential purposes as "residential improvements" clearing the way for those units to be taxed at the lower rate.

The LAC reviewed the bill and did not see any unintended consequences for common interest communities. While the LAC did not take a proactive approach to supporting the bill, we did not see any unintended consequences for common interest communities in Colorado. However, the bill was killed by the House Appropriations Committee.

CCIOA Exempt Associations-On January 28, 2014, Senator Owen Hill (R-El Paso) introduced Senate Bill 14-140 (SB 140) which would have impacted the lien rights of those HOAs which fall within the Colorado Common Interest Ownership Act (CCIOA) exception for small new cooperatives and small and limited expense planned communities. In order to be permitted to record liens for past due assessments, to foreclose upon those liens and to collect related fees and charges permitted under the declarations for these associations, this bill would have require these HOAs to amend their declarations to adopt all provisions of CCIOA.

SB 140 was postponed indefinitely by the Senate Committee on State, Veterans & Military Affairs at the request of Senator Hill. This meant that SB 140 was dead for the 2014 legislative session and could not be reintroduced during the session. Senator Hill told the Committee that the bill needed more work before potentially being reintroduced next year.