Condominium Market

ALASKA HOUSING MARKET COUNCIL
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TO:	Council Members	SUBJECT:	Condo Task Force Report
FROM:	Glenda Straube Executive Director	DATE:	February 5, 1988

In late November, recognizing the unique problems faced by parties in the condominium market, I requested that the Community Associations Institute (CAI) put together a diverse group of people to provide recommendations to the Council pertaining to solving some of those problems. It had become clear, earlier, that the regional task forces would not have the same time or expertise available to work on the condo issue.

Enclosed is a copy of the report requested from CAI. The recommendations contained within this report are scheduled to be discussed and voted upon, should the Council choose to do so.

Though there are many worthwhile recommendations contained within this report, I will address two major solutions at this time.

REDIRECT THE STOCK OF CONDOMINIUM UNITS ON THE MARKET

Since we are already pursuing alternate public uses for condos, there is no need to address that issue in this memo. The most important issue here, however, is whether the state should become involved in relocating condo owners from marginally operated condo groups to more stable condo projects, with higher owner-occupancy ratios.

Though the implementation of this recommendation would be complex and time-consuming, it could certainly prove to remedy much of the problems experienced by condo owners, while also allowing investors, insurers, and the state, the opportunity to use the vacant projects for many of the public uses we have already discussed.

In recent meetings with Milwaukee representatives of MGIC, it became clear that MGIC is one insurer who is seriously considering these relocation options.

INCLUDE DELINQUENT CONDO FEES IN MODIFICATIONS/REFINANCES

It is true that, oftentimes, condo associations are unable to collect delinquent fees. Though this delinquency can be easily established as a lien against the condo unit through the small claims process, it is often meaningless when a foreclosure occurs; the liens are being extinguished because there are no funds for any second liens.

Yet, this uncollectable debt becomes a burden for all other condo owners, since others must pick up the slack for the operating costs of the association. Those fees are not merely funds for beautification of the common area. They include essential costs of operation: heat; water and sewer; insurance; common electric, etc. With less maintenance and upkeep, the units decrease in value.

When funds are being advanced, through modifications such as HOAP, to help bring delinquent borrowers current, it sets the stage for the following scenario. Condo owner, Mary, qualifies to receive those "advance" funds and she is able to bring her mortgage current. Since she is still working, condo associations will be able to move to garnish her wages to collect the delinquent condo association fees. Now she no longer has the same amount of funds to help her keep her mortgage current.

Though this situation is not being played out yet, it won't be long before condo associations might do what they must to keep the condo groups viable. Ultimately, we are not further ahead in helping the condo owner keep their home.

Now is the time to take seriously the unique problems which condo owners and associations face. It's critical that we find a way to solve the issues of delinquent condo fees, low owner-occupancy ratios, and inadequate standards.

ALASKA CHAPTER
Community Associations Institute
200 W. 34th Ave., Suite 277, Anchorage, AK 99503

December 30, 1987

Glenda J. Straube, Executive Coordinator
Alaska Housing Market Council
624 W. International Airport Rd., Ste. E
Anchorage AK 99518

Dear Ms. Straube:

In response to your request, the Alaska Chapter of the Community Associations Institute called together a task force to recommend strategies and solutions for market problems that affect condomium associations. The task force was comprised of a cross-section of disciplines involved with condominium operation and management; the report prepared is a task force product rather than an official Chapter position.

The condominium community does not exist in a vacuum. All the forces at work within the State affect the individual owners and associations just as they affect owners of single-family residences and businesses in Alaska. At the same time, the "association" in condominiums and homeowner associations exists as an additional administrative layer. The collateral of the owners and financial institutions is administered through it.

None of the problems which associations confront are simple. As a result of the developer and institutional greed or governmental failure to inspect or enforce codes, we have inadequate design, shoddy construction, unsound marketing and financing, poor budgeting and management of associations.

As the task force reflected on problems and solutions, it discovered that even the players familiar with the community association arena did not understand the relationships between owners-units-investors-common areas-boards of directors. It is understandable, then, that financial institutions take for granted the function of the associations, attempting to impose responsibilities without the participation or consent of the very associations which they attempt at times to burden.

This report begins with a list of recommendations, followed by a discussion of five areas of concern. The participants on the task force are listed at the end of the report. There is no governmental agency or financial institution that understands the operation of community associations. The CAI chapter has unique experience to contribute in this arena.

In order to improve the situation with community associations, positive action must be taken now. We trust that you share our concern. The Chapter looks forward to an opportunity to provide specific details for the problems indicated and to develop with your administration solutions that will speed the economic recovery as it affects and is affected by community associations. I can be reached at 563-4849.

Sincerely,
COMMUNITY ASSOCIATIONS INSTITUTE

Gil Lulay

Gil Lulay,
President, Alaska Chapter

ALASKA CHAPTER

COMMUNITY ASSOCIATIONS INSTITUTE

TASK FORCE REPORT

COMMUNITY ASSOCIATIONS
AND
THE ALASKAN HOUSING MARKET

December, 1987

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SUMMARY RECOMMENDATIONS

1. Establish a rating system for community associations. The existing resale certificate could provide a basic set of criteria. The rating system would provide criteria for investors and buyers to use in the evaluation of lending/purchasing decisions. It would also give to associations both criteria and incentives for improvement of association management practices; and major investors a mechanism for consolidating scattered holdings (i.e., REOs).

2. Require continuing education for those individuals who are involved in the housing market and who require state licenses (e.g., contractors, real estate agents, etc.).

3. Encourage continuing education for those involved in the housing market without state licensing requirements (e.g., bankers, title insurance companies, etc.).

4. Define and strengthen by statute the warranty and bonding requirements of developers and interim construction lenders as they become involved in the construction of residential units, especially in community associations.

5. In all mortgage work-out programs in which the State or State agencies become involved, provide that the assessments for the maintenance of the property be current and remain current as a condition of the work-out agreement. Make funds available so this can happen.

6. Provide staffing through the State to support the recommendations above, which staffing may be either through AHFC or through another agency which can appropriately address the well-being of the associations.

7. Provide community association representation in the decision making process with AHFC, so the interests of the owners as they relate to the operations of the associations will be appropriately represented.

8. Establish a licensing procedure for community association managers according to the policies, procedures and standards of the community association management industry.

9. Simplify the functioning of association boards by further defining the scope of liability of board members for actions, and by including community association board members among those boards exempt from liability in AS 09.17.050.

I. MARKET PROBLEMS

The housing market, as it pertains to condominium units, suffers from an oversupply. Major construction-related problems, including poor design, poor location and construction defects as well as negative press coverage have contributed to a pessimistic outlook for the condominium market. It can be anticipated that these conditions will continue and/or worsen.

SOLUTIONS:

1. Pursue strategies and alternatives to reduce, control or direct the stock of condominium units on the market, including:

   a. Develop alternate uses for condominium units. These would include the study and implementation of programs to restructure condominium associations for use as housing for students, housing for State and federally-subsidized housing programs, medical support housing and other alternative uses that may be identified.

   b. Consolidate the current, non-institutional ownership of units into associations that are sound structurally and financially, desireably designed and located and adequately organized and operating so that solid, healthy, stable associations can survive. Such consolidation could involve property trades, whereby an owner in a marginal association could trade his unit for another in a higher-rated association. Set priorities by identifying associations that will be targeted to become investment residential/rental properties, requiring a change in the form of ownership.

2. Establish standards for organization, operation and financing of associations, to assist investors to consolidate the available supply, buyers to make informed purchase decisions and lenders to evaluate the collateral value of various projects, so that the marketable units can retain their value in the housing stock and the marginal units can be organized for other uses.

3. Educate the community -- lenders, real estate agents, attorneys, insurance agents, accountants, managers, developers, owners and buyers -- about the condominium life style, the uniqueness of condominium projects, the management thereof, the relative merits of condominium ownership vs. single family residence ownership, and the rights and responsibilities which accompany each form of ownership.

II. FINANCIAL PROBLEMS

Community associations provide a mechanism for the maintenance of the commonly held property. The association board of directors, made up of volunteer owners, has responsibility for preservation of the commonly held assets.

In some instances, initial budgets prepared by the developers were designed to facilitate sales rather than to provide for the financial health and stability of the associations. All budgets were reviewed and approved by the interim construction lending institutions and investors such as AHFC.

Also, in some instances, prices for units under construction were influenced by the existing loan programs (e.g. HOF, the $80,000 base loan subsidy). Construction costs were driven by potential selling price rather than on quality control standards for construction within the Alaskan environment.

These inadequate budgets and construction deficiencies have resulted in ....

-- shortfalls in operating budgets

-- inadequate capital reserves for replacements

-- special assessments to cover constuction defect repairs

-- litigation with developers to settle construction disputes

-- extended negotiations with developers and successor developers to remedy defects

In addition to the internal problems of the Associations, the economic recession and depressed real estate market have put condominium units in an unfavorable and undesireable sales position. A relatively high percentage of condominium units have become delinquent in both the mortgage loan and association assessment payments. Foreclosures and bankruptcies create bad debt burdens for all parties. Associations must increase regular or special assessments to recoup the loss in order to meet operating expenses and reserve funding requirements.

SOLUTIONS:

thru the horizontal act?

1. Establish industry standards/guidelines to be used by interim construction lenders, developers and investors such as AHFC in evaluating the adequacy of project budgets, and by Boards of Directors in making decisions for the operations of community associations. These would include standards/ guidelines for analyzing and evaluating operating budgets and capital reserve schedules.

2. Establish warranty and bonding requirements for developers and interim construction lending institutions which cover a period of time adequate to allow for the development, discovery and repair of construction defects.

3. Establish standards, policies and procedures to evaluate existing projects to determine, in the best way possible, the most viable associations. Then, attempt to consolidate financially stable owners in sound associations. This would preserve and increase the values of the best associations. It would also increase the options for utilizing the worst properties, because it would make them available to larger investors as residential/rental investment properties.

   The standards must provide for an evaluation of the associations, based on financing, maintainability, amenities, location, desireability, physical condition and any other identifiable condition which might have an impact on the future potential of the property.

With no intervention, every association in the state will be weakened by the downward spiral in the market. The contamination created by foreclosures will continue to spread and grow, because each foreclosure creates an additional burden on the association and every other owner within tne association. When a unit becomes vacant due to foreclosure, a share of "desireability" for the association is lost, and when the percentage of vacancies and foreclosures is high enough, the determination to "hang on" can be eroded to the point where the last foreclosures come much more quickly than the first.

* **<u>The policy decision required</u>**: The State must intervene to establish an evaluation process which will rate associations. The strongest associations should be supported to continue, and the weakest should be supported to convert to alternate forms of ownership.

The procedures involved: A rating system should be developed, supported by competent staffing. A basic evaluation format already exists in the resale certificate, a disclosure statement mandated by the Alaska Common Interest Ownership Act. Voluntary participation on the part of associations should be encouraged. Participation of investors and homeowners should be obtained. Association managers have a special contribution to make. The Alaska Chapter of the Community Association Institute provides a channel to a wide assortment of practitioners in the community association field, and a great deal of information is available, both locally and nationally, to help with evaluation criteria.

Although this process would be extremely complex, it appears to be the only process by which significant movement can occur in the market and the supply of investment capital can be increased.

4. All workout programs which provide funds to cover delinquent balances on mortgages should include funds to bring delinquent condominium fees current.. These fees are not ordinary delinquent bills, comparable to other charge accounts or consumer loans. They cover the cost to maintain the property which is the collateral for the mortgage loan, and continue to accrue each month. As such, they are bills in which the investor has a primary stake because they pay for the maintenance of the property which is the security for the mortgage loan. Funds should be advanced at the time of any workout arrangement to bring assessments current. The advancement of funds would be authorized by the investor and repayment would be added to the end of the loan.

III EDUCATION / AWARENESS / ATTITUDES

Professionals dealing in the financing and sales of units in common interest communities, and especially in condominiums, deal with the individual units primarily, and come into contact with the associations only when functionally necessary. The role of the association in the maintenance of the mortgaged asset has been ignored by the financial and governmental institutions making decisions about mortgaging, lending, work-out and forebearance programs. The impact their decisions have on the associations is significant, and, at times, critical to the health and financial stability of the Associations. If the Association fails, the lender's and owner's security is jeopardized.

Education to affect the awareness and attitudes of the participants is needed for....

-- the financial community, so they understand, support and involve the associations in the decisions that impact them. -- the real estate community, so they understand the product they are marketing, and qualify prospective buyers based on life-style as well as financial capability.

-- the Associations and Association members, so they understand their responsibilities within the associations to participate in the successful functioning of the association.

-- the managers of associations, so they understand the associations responsibility to the membership and their responsibilities to both.

-- the general public, so they understand the complexity of the condominium market, community and life style.

SOLUTIONS:

1. Establish continuing education standards and requirements for the real estate industry.

2. Establish registration/certification requirements for communityassociation managers.

3. Provide adequate staffing and continuing education for the Community association support department at AHFC.

4. Encourage AMBA to create educational opportunities for participants from member organizations regarding community association operations, problems and services.

5. Education must be a major part of any activity to rate associations and support them. Provide State support in the form of grants to do public education.

IV GOVERNMENTAL REGULATIONS/LENDER GUIDELINES

Governmental regulations and investors guidelines relating to community associations are confusing, complex and inconsistently enforced. An example is the application of the owner-occupancy ratio, which is incomprehensible in its concept, disastrous, discriminatory and arbitrary in its application.

As the real estate market has deteriorated, the problems confronting the associations have increased. The staffing provided by the investors such as AHFC to deal with the Associations and their problems, at the same time, has diminished. The reduced staffing appears to indicate a lack of awareness, concern and commitment to support the very entities which protect the security of the investment.

Project certification guidelines are meaningful for project approval or disapproval, but they do not help the association work through problems and they do not provide meaningful standards to be used by the associations in decision making and problem resolution. Communication channels and information exchange are severely restricted. The decision- making processes within the financial institutions are not accessible to the associations and their representatives.

SOLUTIONS:

1. Increase AHFC support staff assigned to the Community Association review and support department.

2. Reevaluate guidelines for Seller Servicers and develop guidelines which are appropriate to the Alaskan situation.

3. In the evaluation process, base decisions on standards which can be cited as the basis for approval/disapproval.

4. Establish an appeal procedure in the certification process so that associations can appeal decisions which will drastically affect the health and well being of the association and its members.

5. Establish guidelines to assist in the evaluation and maintenance of financial health for the associations rather than diagnosing for developing illness. Stress prevention rather than cure.

6. Establish procedures that involve community associations in the AHFC decision making process, where rules, regulations and decisions impact associations.

7. Establish a program to provide grants to community associations for capital reserve programs analyses. This should involve establishing standards for the studies as well as loans to cover the costs.

8. Establish a policy that will support the continued, increased health of the best associations, provide for transfer of owner resources from the worst to the best, and develop alternate uses for associations which are identified as not practically viable as condominiums for the future.

9. Establish a foreclosure procedure for systematic and timely transfer of ownership from the mortgagor to the mortgagee, so that the ownership responsibilities to the association are continuously met.

V. MANAGEMENT

The management of the Associations is the responsibility of the boards of directors. Declaration and bylaws provide procedures for decision making and management. But, since the board of directors is made up of volunteers, how do they become educated to the requirements of their fiduciary responsibilities in managing the assets for which the association is responsible?

SOLUTIONS:

1. Provide incentives to Boards of Directors who pursue association operation education for members and other homeowners. This could involve the sponsorship of seminars, workshops, study days, or other special projects to educate involved individuals about all the aspects of community association operation.

2. Provide an evaluation and grading system that acknowledges and rewards those associations that achieve excellence in the management of their assets.

3. Obtain statutory exemption from liability for association board members except in the case of malice or willful negligence by their inclusion in AS 09.17.050..

4. Simplify the amendment process for adoption of AS 34.08 (Alaska Common Interest Ownership Act) provisions by existing associations.

5. Establish a program to certify or register community association managers, establishing experience and educational requirements, both for initial registration/certification and for renewal of same.