McGovern
Legal Services, LLC

Newsletter

Fall/Winter
2017

Avoiding Too Many Rentals

By: Amy E. Forman, Esq.

Recently, investors' interest in condominium associations has spiked and many people have started investing in condominiums for the purpose of leasing units. Many condominium associations are struggling with the unexpected consequences of having too many rentals. Many of these renters, who tend to be short-term tenants, do not share the same long-term interests in the community as permanent residents may. Additionally, mortgage lenders often consider the number of rentals within a community and refrain from providing credit to individual unit owners if there is a large percentage of units rented. In hopes of maintaining the residential character of the association, as well as encouraging mortgage lenders to provide financing, what can an association do to control the number of investors and rentals?

Leasing restrictions are the most common solution. This is done by an amendment to the Association's governing documents, passed by a membership vote. The exact percentage of votes needed to pass the amendment can be found in the Association's governing documents. The Association must provide notice of the proposed amendment and hold an open meeting at which the community vote on the proposed amendment.

Some common leasing restrictions include the following:

1. Capping on the number of units that may be rented at a time. For example, the Association may implement a rule that no more than twenty percent (20%) of the total units within the Association may be leased at any given time.
2. Requiring a unit owner to reside in his/her unit for a minimum period of time (typically one year) before he/she is permitted to lease the unit. An investor may have no interest in living in the unit and is likely looking to move a tenant in the unit as soon as possible. Therefore, investors are likely to shy away from Associations that mandate all owners reside in the unit for one year before leasing the unit.
3. Placing restrictions on the number of units an individual can own. The goal of this restriction is to stop an investor from purchasing multiple units within the Association.

When adopting leasing restrictions, Boards should include hardship provisions for any owner who would be seriously disadvantaged by the leasing restrictions. These hardship provisions will allow the Board, at its discretion, to grant permission to a unit owner to rent out his/her unit, even if doing so would somehow violate the leasing restrictions. This hardship exception should be used narrowly and only in exceptional cases to prevent an excessive hardship on the owner.

By implementing these leasing restrictions, the Association is able to ensure that it's community remains primarily owner-occupied.

Contingent Fee Agreements for Transition Litigation: Are you getting charged correctly?

By: Damon M. Kress, Esq.

Litigating against a community's developer over construction defects and other issues is a long, slow and expensive process. An average transition lawsuit can take between five (5) and seven (7) years to reach conclusion. As if the glacial pace were not bad enough, if an association pays for its transition litigation "out of pocket", attorney fees could cost $750,000 or more, even if the matter does not reach trial. In addition to engaging an attorney, associations must hire forensic engineers, and often forensic accountants to substantiate their claims against the developer and numerous sub-contractors. The cost of those forensic services can easily add another $200,000 to $600,000 to the cost of the litigation. Therefore, the total average cost of transition litigation can easily range from $750,000 to more than $1,000,000. In certain cases, the total cost of the litigation can substantially exceed $1,000,000.

Few associations can afford to spend such substantial sums on litigation, especially when recovery is not guaranteed. Even those associations that could amass sufficient funds from the membership, to pay those costs, may prefer not to because increased assessments may be unpopular with the members. Whatever the reason, over the last decade, contingent fee agreements have become a more popular option for transition litigation.

Most people have little to no actual experience entering into contingent fee agreements with attorneys. Instead, most people's only familiarity with contingent fee agreements comes from movies and television where lawyers always seem to get paid a third (1/3) of whatever they recover for the plaintiff. Unlike television, however, in New Jersey the Supreme Court adopted very specific rules and limits for how much an attorney may charge as a contingent fee for the majority of claims an association would pursue against a developer, and its sub-contractors. Those rules are found in Court Rule 1:21-7.

As explained in Court Rule 1:21-7(c), in any matter where the association's claims for damages are based upon the alleged "tortious conduct" of another (tortious conduct generally means civil wrongful acts, or an infringement of rights, that arise out of something other than a contractual agreement), a contingent fee arrangement may not exceed the limits set forth in the Rule. The Rule lays out a five-tiered framework for calculating the contingent fee, where each tier establishes a ceiling on the percentage of the recovery the lawyer can charge the client as a contingent fee.

Under a tort-based contingent fee arrangement, the Association's attorney may only collect:

1. 33⅓% on the first $750,000 recovered;
2. 30% on the next $750,000 recovered;
3. 25% on the next $750,000 recovered;
4. 20% on the next $750,000; and
5. On all amounts recovered in excess of $3,000,000 the attorneys must apply to the Superior Court for a determination of a reasonable fee in light of all the circumstances.

Contributing Writers:

Amy E. Forman, Esq.

Damon M. Kress, Esq.

David W. Merritt, Esq.

Patricia Hart McGlone, Esq.

It is also important to remember that, pursuant to Court Rule 1:21-7(d), the contingent fee is computed on the net sum recovered after deducting all disbursements in connection with the litigation, regardless of whether those disbursements were advanced by the attorney or by the client. These disbursements include investigation expenses, expenses for expert or other testimony or evidence, and any interest included in the judgment pursuant to certain Court Rules.

An example of how to calculate a contingent fee for a hypothetical transition litigation should help put the application of these concepts and rules into context.

Example:
Association entered into a contingent fee agreement with Lawyer to sue Developer. The contingent fee agreement was written in accordance with the limits set forth in Court Rule 1:21-7. Association succeeds in its case and wins a $3,000,000 judgment against Developer. Association paid a total of $500,000 to cover various disbursements spent in furtherance of the Association's successful litigation. Developer immediately pays the $3,000,000 into Lawyer's attorney trust account satisfying the Association's judgment in full.

Question: How much does Association owe Lawyer pursuant to the contingent fee agreement?

Gross sum recovered: $3,000,000
Less – Disbursements: ($500,000)
Net sum recovered: $2,500,000

Contingent Fee Calculation:
1. 33⅓% on the first $750,000 recovered - $750,000 x .3333 = $250,000
2. 30% on the next $750,000 recovered - $750,000 x .30 = $225,000
3. 25% on the next $750,000 recovered - $750,000 x .25 = $187,500
4. 20% on the next $750,000; and - $250,000 x .2 = $50,000

Total Contingent Fee: $712,500
Answer: In this case, the Association owes Lawyer a contingent fee of $712,500. In this example, Court Rule 1:21-7 did not require an application to the Superior Court because the net sum recovered did not exceed $3,000,000.

It is important to understand the limits the Supreme Court placed on the calculation of contingent fees because it can dramatically affect how much an association pays for these legal services. For example, in the scenario described above, if the fee agreement simply provided that Lawyer would receive one-third (1/3) of the gross sum recovered ($3,000,000) Association would owe Lawyer a $1,000,000 contingent fee. Not only would Association's fee agreement violate Court Rule 1:21-7, the improper fee agreement would also result in Association overpaying Lawyer $287,500 for this litigation ($1,000,000 - $712,500 = $287,500).

Moreover, if the fee agreement simply provided that Lawyer would receive one-third (1/3) of the net sum recovered ($2,500,000), Association would owe Lawyer a $833,333 contingent fee. This fee agreement would also violate Court Rule 1:21-7 and the improper fee agreement would result in Association overpaying Lawyer $120,833 ($833,333 - $712,500 = $120,833). Either way, both improper fee agreements result in Association overpaying significantly for the legal services.

These examples demonstrate how easy it is for an association to overpay for legal services under a contingent fee agreement if the board of trustees does not take precautions to ensure the agreement complies with Court Rule 1:21-7. The overpayment can potentially skyrocket in instances where the net sum recovered exceeds $3,000,000. Furthermore, even if the agreement itself complies with the Court Rule, board members should also be vigilant to ensure that any contingent fee the association ultimately pays to the lawyer is calculated in compliance with Court Rule 1:21-7.

How can a board of trustees reduce the possibility the association is overcharged under a contingent fee agreement?

An independent attorney could review the contingent fee agreement for compliance with Court Rule 1:21-7. As explained above, the Court Rule provides a very simple tiered framework for the calculation of contingent fees. An independent counsel should have little difficulty determining whether the agreement the association is considering entering into, or already entered into, complies with the Court Rule.

In addition to reviewing the agreement for compliance with the Rule, when the litigation reaches conclusion, the association may also wish to have independent counsel review the calculation of the contingent fee for compliance with Court Rule 1:21-7. Having independent counsel evaluate the actual contingent fee payment for compliance with the Court Rules should provide the board of trustees the greatest assurance that the association is not overpaying.

An association may benefit from having an independent counsel review the contingent fee payment at the conclusion of the litigation regardless of whether the association had independent counsel initially evaluate the agreement. Court Rule 1:21-7 is very clear, "an attorney shall not contract for, charge, or collect a contingent fee in excess of the following limits." In light of this language, even if the Association voluntarily enters into a contingent fee agreement that does not comply with the Rule, the attorney is expressly prohibited from charging or collecting a contingent fee from the Association that is calculated in a manner that does not comply with the methodology established by Court Rule 1:21-7.

Contingent fee agreements are one option a board of trustees can consider. With some relatively simple counsel and oversight, the board of trustees can ensure that their association does not overpay for the services the association receives under the contingent fee agreement. Please contact our office regarding our contingent fee agreements or if you would like to have our firm evaluate an existing contingent fee agreement.

New Election Law

By: David W. Merritt, Esq.

On July 13, 2017, the State enacted P.L. 2017, Ch. 106 often referred to as the Radburn bill, a supplement to the Planned Real Estate Development Full Disclosure Act intended to ensure Condominium, HOA, and Cooperative elections are conducted in a fair and open manner. The new Law contains important new procedural and substantive requirements for: (1) Membership Voting Rights; (2) Board Elections; and (3) Bylaw Amendments. Management and Boards must navigate these new requirements carefully, else they may face costly challenges to the validity of Association elections and Bylaw Amendments.

Except for new notice and ballot rules for elections in Associations with 50 or more Units, the new Law became effective on July 13, 2017. The new notice and ballot rules become effective on October 1, 2017.

Membership Voting Rights:

The new law provides, "Membership in the association of a planned real estate development shall be comprised of each owner within the planned real estate development[.]" N.J.S.A. 45:22A-43.1.c. This means that except for owners not in good standing, all owners must be permitted to run for the Board and vote on Board elections and Bylaw Amendments, even if otherwise prohibited by an Association's Governing Documents.

The new law also creates a definition of standing to be applied in determining whether a member is eligible to run for the Board and vote on Board elections and Bylaw Amendments: "Good standing" means the status . . . applicable to an association member who is current on the payment of common expenses, late fees, interest on unpaid assessments, legal fees, or other charges lawfully assessed, and which association member has not failed to satisfy a judgment for common expenses, late fees, interest on unpaid assessments, legal fees, or other charges." N.J.S.A. 5:22A-23.7. Members who are compliant with a payment plan or who are actively disputing the charges in ADR or in Court must also be permitted to run for the Board and vote on Board elections and Bylaw Amendments. N.J.S.A. 5:22A-23.7.

It is important to note the new good-standing requirements do not apply to revocation of other Membership rights, such as use of the amenities. Good-standing clauses in Associations' Governing Documents still control as to those rights, meaning many Associations will now have 2 separate tiers for members in bad standing. For this reason, some Associations may decide to simplify the categories by amending their good-standing clauses to conform with the definition in the new Law.

The new law also permits Tenants to run for the Board and vote on Board elections and Bylaw Amendments if both: (a) permitted to do so by the governing documents; and (b) granted the right either by the Unit Owner in writing or by historical practice of the Association prior to enactment of the new Law. N.J.S.A. 5:22A-23.s.

Board Elections:

The new law establishes new procedural requirements for Board elections:

(1) All proxy ballots must contain the following disclaimer. N.J.S.A. 45:22A-45.2.a. This proxy is voluntary on the part of the granting owner, and can be revoked at any time before the proxy holder casts a vote. Absentee ballots are available.

(2) If proxy ballots are permitted, then absentee ballots must also be made available. N.J.S.A. 45:22A-45.2.a.

(3) Associations must allocate election votes equally amongst the units unless the Governing Documents weigh the votes based upon the size or value of each unit. N.J.S.A. 45:22A-45.2(c)(9).

(4) No more than 1 Trustee per unit may serve on the Board. N.J.S.A. 45:22A-45.2.f(1)(e).

For Associations with 50 or more Units, the following additional requirements apply, and become effective as to any election scheduled after October 1, 2017.

(1) No Trustee may be appointed without a Member election, unless to fill a vacancy due to resignation, death, failure to maintain qualifications or good standing, or removal by membership vote. N.J.S.A. 45:22A-45.2.f(3)(a).

(2) No Trustee shall be elected to a term of longer than 4 years. N.J.S.A. 45:22A-45.2.c(1).

(3) Stand-ins with a valid proxy or power of attorney must be permitted to vote. N.J.S.A. 45:22A-45.2.c(2).

(4) Associations must provide a first notice of the election at least 30 days ahead of the meeting notice, allowing the owners at least 14 days to nominate candidates. N.J.S.A. 45:22A-45.2.c(3).

(5) All candidates in good standing must be included on the ballots if they were nominated by the deadline provided in the nomination notice, or if no deadline was specified, by the business day before mailing of the meeting notice. N.J.S.A. 45:22A-45.2.c(4).

(6) Associations must mail a second notice of the election between 14 and 60 days ahead of the meeting, setting forth the date, time, and location of the meeting. N.J.S.A. 45:22A-45.2.c(5).

(7) Unless prohibited by the Bylaws, the meeting notice shall include both a proxy ballot and an absentee ballot listing all valid candidates in alphabetical order by their last name. N.J.S.A. 45:22A-45.2.c(5) & (6).

Election meeting notices may be sent electronically, but only if the Governing Documents permit electronic notice or the member agreed to accept electronic delivery. N.J.S.A. 45:22A-45.2.c(5).

Smaller Associations with less than 50 Units are excepted from these additional requirements, although they must still hold fair elections, and should generally conform to the new notice requirements as the best practices recognized by the State. N.J.S.A. 45:22A-45.2.b.

Bylaw Amendments:

The new law also enables Members to amend the Bylaws if the Governing Documents either don't provide for such an Amendment, or if the Governing Documents require more than 2/3 of the Members vote to pass any Amendment to the Bylaws. N.J.S.A. 45:22A-46.d(2). In either of those circumstances, the following default provisions control.

(1) Members may amend the Bylaws by a majority vote of all Members in good standing. N.J.S.A. 45:22A-46.d(2).

(2) The Members may call a Bylaw Amendment vote by petition signed by at least 15% of the membership. N.J.S.A. 45:22A-46.d(2)(a).

(3) The Bylaw Amendment meeting must be held within 60 days of the Association's receipt of the petition. N.J.S.A. 45:22A-46.d(2)(b).

(4) The Association must revise the proposed Amendment to clarify any ambiguities and to conform with the other provisions of the Bylaws and with applicable laws. Notice of the meeting, together with the proposed Amendment, must be sent to the Members at least 10 days prior to the meeting. N.J.S.A. 45:22A-46.d(2)(c).

(5) If proxy ballots or absentee ballots are permitted by the Bylaws, then the Association must accept ballots submitted by mail, facsimile, and email up to 1 business day before the meeting. N.J.S.A. 45:22A-46.d(2)(d).

Individual aspects of these requirements also control as default provisions if an Association's Bylaws are not sufficiently clear on the procedure for amending the Bylaws. N.J.S.A. 45:22A-46.d(2).

Finally, the new Law grants Boards the power to amend the Bylaws directly where either: (a) the Amendment is necessary to comply with the law; or (b) the Members are given notice and opportunity to reject the proposed amendment. N.J.S.A. 45:22A-46.d(5). If at least 10% of the Members oppose a Bylaw Amendment that is not necessary to comply with the law, then the Board cannot pass the Amendment. N.J.S.A. 45:22A-46.d(5)(b).

Given the vast diversity of language in New Jersey Condominium, HOA, and Cooperative Governing Documents, application of the new Law will create many novel conflicts and issues that will have to be analyzed and resolved on a case-by-case basis. Boards should be encouraged to review their Governing Documents with the Association's attorney to identify and head off any such issues ahead of the Association's next election or Bylaw Amendment. Failure to conform with the new Law and resolve any conflicts ahead of time may result in an invalid Membership vote, putting the Board in the politically embarrassing position of having to void the results and administer a second meeting.

McGovern Legal Services, LLC is thoroughly familiar with applying New Jersey's ever-shifting laws and regulations to a wide range of Governing Documents and circumstances. If Management or the Board have questions about how to administer elections or Bylaw Amendments in light of the new Law, anticipate Membership challenges and unrest at the Association's next election, or struggle with reaching quorum to hold an election or amend the Bylaws, then the attorneys at McGovern Legal Services, LLC would be pleased to assist your Association.

Bonds May Be Released But The Association's Claims Are Not!

By: Patricia Hart McGlone, Esq.

The transition process involves an engineering evaluation of the Association's common elements to determine if there are defects. The engineer's evaluation typically identifies defects within the site improvements, for example, the landscaping, roadways, sidewalks, detention basins, etc. These site improvements are often subject to performance bonds with the municipality.

New Jersey statute N.J.S.A. 40:55D-53 permits municipalities to require a developer to post a performance bond guaranteeing the construction of site improvements. The amount of the performance bond is calculated by the municipal engineer and is intended to cover the cost of constructing the site improvements in the event that construction is not completed or completed improperly. The developer is then required to post a cash bond, a surety bond payable to the municipality, or a combination of the two, in order to guarantee the construction of the required improvements.

As construction progresses, the municipal engineer will inspect each site improvement and issue a report stating whether or not it was constructed in accordance with the approved plans. The municipality (typically a township council) will then decide whether to reduce or release the performance bond after taking the municipal engineer's findings into consideration. Each municipality enacts ordinances setting forth the requirements and procedures for the performance bond process. Therefore, the process may vary depending on the municipality where the construction site is located.

The Association's transition engineering evaluation should be submitted to the Township Clerk and Township Engineer when received, because the Association wants to alert the municipality that construction defects have been identified in the site improvements before the developer's performance bonds are released. This way the Township Engineer will have the benefit of reviewing the Association's engineering report, and the description of those defects, when deciding whether to recommend a reduction or release of the performance bond to the municipality.

Interestingly, in K Hovnanian at Lawrenceville, Inc. v. Lawrence Township Mayor and Council, 234 N.J. Super. 422 (Law Div. 1988) the court held that the Township Council could not refuse to release or reduce the performance bond where the Township Engineer recommended doing so. The court noted that homeowner complaints of defective soil and drainage conditions were not sufficient for the Township Council to deny the developer's request for bond reduction. However the court stated that the Township Council would have discretion to deny the request if confronted with competent evidence such as an engineering report.

What happens if an Association receives its transition engineering evaluation after the performance bond has already been released?

Some developers "refuse to consider" an Association's construction defect claim for bonded improvements if the municipality already accepted the construction of the improvements and released the associated performance bonds. Do not accept this disingenuous argument. The Association may pursue claims against a developer, for the defective construction of bonded improvements, even if the items were subject of a performance bond and the municipality already accepted the construction and released the developer's performance bonds for the improvements.

1. First, submit the engineering report to the municipality anyway as there may be a maintenance bond in place. Most municipalities require developers to post a two year maintenance bond once the performance bond is released. The municipality may perform repairs or replace unacceptable improvements and charge the cost against the maintenance bond.
2. Second, the Association may pursue claims against the developer for the defective site improvements because the Association is not a party to the performance bond agreement. Instead, the bonding agreement is only an agreement between the municipality and the developer. As a result, the Association is not bound by actions taken by the municipality or the developer, pursuant to the bonding agreement.
3. Third, the municipal engineer's report indicating that construction was completed in accordance with the plans is not binding on the Association.

The municipal engineer's report recommending release of a performance is similar to the municipal construction official's issuance of a certificate of occupancy. In DKM Residential Properties Corp. v. Township of Montgomery, 182 N.J. 296 (2005) the New Jersey Supreme Court held that a municipal construction official had authority to issue notices of violation for failure to comply with the Uniform Construction Code to a developer for defective EFIS construction after the certificates of occupancy were issued by the municipality. The court noted that the Code does not limit its enforcement after a certificate of occupancy has been issued.

By analogy, the municipality's acceptance of a site improvement does not limit the Association's right to pursue a claim against the developer for Code violations or other basis of construction defect. The Association obtains its right to pursue construction defect claims against the developer by virtue of the contractual provisions of the Public Offering Statement, the contracts of sale between the developer and the various purchasers, and the Association's other governing documents. In addition to these contractual rights, the Association also has independent rights to pursue the developer, on behalf of the unit owners, for various tort based claims relating to the common elements. See Condominium Act, N.J.S.A. 46:8B-12, Siller v. Hartz Mountain Assocs., 93 N.J. 370, 380, cert. denied, 464 U.S. 961 (1983).

Practical advice:

- It is often helpful to keep the lines of communication between the Association and the municipal engineer open because the Township can be a great asset by holding the developer's "feet to the fire" and making sure the site improvements are constructed properly.
- If the Association's engineer identified construction defects after the bonds are released, the Association's transition counsel should be armed and ready to dispute the developer's contention that it is not responsible for site improvement defects once the municipality has accepted them and released the bonds.

Pending legislation of concern:

Finally, everyone should be aware of pending legislation that is attempting to limit the developer's obligations for performance and maintenance guarantees under the Municipal Land Use Law (A1425). The proposed legislation would only require a performance bond for those improvements that will be dedicated to the municipality after completion and a municipality would only be able to require a performance bond for privately owned perimeter buffer landscaping. The proposed bill would remove the following improvements from the performance bond requirement: culverts, storm sewers, erosion control, and landscaping.

This legislation, if adopted, would leave an Association with defective private roadways or storm sewers to fend for itself with regard to construction defects and removes the first layer of protection that was provided by the municipality and the performance bond.

The cost to remedy construction defects in these improvements can be substantial. This proposed legislation does not benefit Associations.