

**BUDGETS, RESERVES AND THE OHIO REQUIREMENT FOR AN ANNUAL OWNERSHIP VOTE IF RESERVE FUNDING IS TO BE WAIVED**

THE SPECIAL ASSESSMENT PROBLEM

The history of Ohio condominiums has been plagued by “special assessments.

In the past, condominiums typically included in their budgets the association’s day-to-day operating and maintenance costs. Pressure on boards to keep maintenance fees low too often resulted in bare bones budgets with only basic necessities being paid. Many associations failed to build up savings, known as “reserves,” for large future expenses such as roof, siding or roadway replacement. Because the costs of long-term replacement projects were not included in association budgets, condominiums across Ohio experienced devastating budget shortfalls. Boards have been left with no choice but to levy special assessments, often fully payable within a month or two, in amounts from the thousands to tens of thousands of dollars. In many instances, the amount of the special assessment has exceeded twenty percent (20%) of the unit’s value. Recently, there has even been an instance where the amount of the special assessment approximated the total value of the units. Ohio condominium owners faced large special assessment bills with little or no time to pay. Needless to say, condominium owners across the State could ill-afford these special assessments often resulting in foreclosures and always resulting in ownership dissatisfaction.

Another serious issue arose when condominium owners sold their units to new purchasers without disclosing the potential for special assessments. This game of “condominium roulette” proved to be financially devastating to new owners who faced huge special assessments shortly after their purchase with no warning that special assessments were forthcoming. Purchasers would put virtually one-hundred percent (100%) of their savings into the down-payment and/or fixing up their new condominium only to be “hit” by the surprise special assessment. As an example, a purchaser of a $170,000 condominium unit in March of 2004 was “hit” by a roofing special assessment of $27,000 in August of 2004 with the special assessment being fully due by December 15, 2004. “Condominium roulette” has resulted in the filing of innumerable lawsuits against sellers, real estate agents, and associations alleging failures to disclose. Results were mixed, but litigation is costly and demoralizing for all sides. More importantly, the innocent losers at “condominium roulette” voiced high dissatisfaction with ownership of their new home.

OHIO’S NEW LAW

Recognizing the terrible consequences from associations having to levy special assessments, and perhaps also mindful of the increasing popularity of condominium ownership in Ohio, the Legislature acted in 2004, passing House Bill 135.

When Governor Taft signed House Bill 135 into law in July of 2004, major changes were made to Ohio’s condominium statute. One of the most significant changes to the law is the requirement that the board include “reserve” funding in the budget so as to avoid special assessments. Generally, the new law requires that condominium boards either: 1) provide for “reserve” funds in the association’s budget so as to avoid special assessments, or 2) obtain a majority vote annually of the ownership to waive the reserves.

Specifically, Ohio Revised Code Section 5311.081(A)(1) states:

(A) Unless otherwise provided in the declaration or bylaws, the unit owners association, through the board of directors, shall. .

(1) Adopt and amend budgets for revenues, expenditures, and reserves in an amount adequate to repair and replace major capital items in the normal course of operations without the necessity of special assessments, provided that the amount set aside annually for reserves shall not be less than ten percent of the budget for that year unless the reserve requirement is waived annually by the unit owners exercising not less than a majority of the voting power of the unit owners association;

(emphasis added)

As the language of the law indicates, the intent of the legislature in enacting House Bill 135 was to require condominium boards to include reserve funding within their regular budgets. The new language expressly states that the reserves “shall” be adequate to cover replacement costs “without the necessity of special assessments.” The law in Ohio now intends to lessen, if not alleviate altogether, the practice of boards’ levying special, and often unexpected, assessments on owners.

Where special assessments are levied in the future, they will no longer be unexpected. The law requires boards to adopt and amend budgets for reserves unless the unit owners vote to waive the requirement. Special assessments will not be a surprise to unit owners who have voted each year to operate with “under-funded” reserve accounts. A MAJORITY OF THE OWNERSHIP’S VOTING POWER IS NECESSARY TO WAIVE THE FULLY FUNDED RESERVE REQUIREMENT, AND THE VOTE FOR WAIVER MUST BE TAKEN EACH YEAR.

“Under-funded” reserves exist when the budgeted amount for reserves is not enough to accumulate enough money over time to cover the cost to repair or replace an item without the necessity of a special assessment. In this circumstance, owner votes waiving the reserve requirement must be taken. Again, if the unit owners are voting each year to “under-fund” the reserves, a special assessment will be no surprise. While no one should be surprised by a special assessment when reserve requirements are waived, prudent boards should keep the written ballots used to obtain the waiver as part of their records. Those ballots should remain in the association’s records forever.

BOARDS STILL HAVE A CHOICE

As noted above, the new condominium statute in Ohio mandates that boards either fund reserves or obtain a vote of the unit owners to waive the requirement. The statute states that funding of reserves is necessary unless it “is waived annually by the unit owners exercising not less than a majority of the voting power of the unit owners association.” Notably, the law requires a majority vote to waive the requirement, measured according to each individual association’s voting scheme. This language is important, as in some associations each unit owner is entitled to one vote, with each vote weighted equally. In other associations, percentages of voting rights are assigned, not necessarily equally, to each unit. In the latter arrangement, larger or more valuable units may have a larger percentage than some other units. The most common example of a weighted scheme is often found in high-rise condominium buildings, in which top floor “penthouses” may have twice the value of lower-level units. Under the new condominium law in Ohio, the required vote to waive reserves must be passed not by a majority of those voting, but a majority of the voting power of the entire association.

Also notable is the new law’s requirement that boards obtain a vote to waive the reserve requirements annually. As discussed above, absent a vote to waive the reserve requirements, Ohio law requires boards to include reserves in their budgets. Accordingly, a vote in 2005 by the “ABC Condominium Association” to waive reserves for the association’s 2006 budget has no effect on budgets beyond 2006. If the ABC Condominium Association were to fail to obtain an affirmative vote (such as by taking no vote at all) to waive the requirement for 2007 and nevertheless failed to budget reserves, the board would be in direct violation of Ohio law. In this respect, the Ohio legislature has retained the ability of boards to choose whether to fund reserves, but because inaction will result in the necessity to budget such funds, lawmakers in Ohio have made clear that, when feasible, fully-funding reserves is preferred.

A final consideration of the new reserve requirement is the language: “provided that the amount set aside annually for reserves shall not be less than ten percent of the budget for that year.” THIS LANGUAGE DOES NOT STATE THAT A BOARD WILL BE IN COMPLIANCE WITH THE LAW IF IT BUDGETS TEN PERCENT (10%) OF ITS TOTAL BUDGET FOR RESERVES. Rather, the law sets the minimum reserve as “an amount adequate to repair and replace major capital items in the normal course of operations without the necessity of special assessments.” The ten percent (10%) language applies only when the “adequate” amount is less than ten percent (10%) of the association’s total budget. As an example, if a developer is still in control of a two-year old development and the association’s annual budget is $50,000 with only $4,000 being put into reserves, an ownership vote will still be necessary. Clearly, Ohio’s new law is also aimed at requiring developers to initiate adequate reserve funding from the very beginning of the condominium’s existence.

RESERVE STUDIES

How does a board know how much money is enough to repair or replace a major item? How does it know whether its reserves are adequately funded? How are owners notified how much in reserves they are being asked to waive? To ascertain these numbers, a board should seriously consider hiring an outside firm to perform a “reserve study.” While Ohio law does not specifically require a reserve study, it is virtually impossible to have the owners intelligently vote on waiving reserves if the owners are not told how much they are waiving. A reserve study will contain a listing of each of the component parts of the association property. (e.g. the siding, roof, driveways, boilers, hallway carpeting and wallpaper) Next, the study will predict the useful life of each component part and the replacement cost of each. The replacement cost of each component part will be divided by the useful life. The result is the amount of money that should be allocated to the reserve account annually. Once this amount is determined for each of the component parts, they all should be added together and the total amount added to the budget or disclosed to the owners as a part of the reserve waiver ballot. If the total amount is added to the budget, the reserves are “fully funded.” Once the reserves are fully funded, special assessments will not be necessary and the board has complied with the new law.

Compliance with the law means avoiding liability. The easiest way for the board to avoid liability is to obtain a professional reserve study; immediately share the results of the reserve study with all owners and either: 1) adopt a budget that is in accordance with the reserve study recommendations or 2) obtain a majority vote of the ownership waiving the reserves requirement for that particular year.

SELLER’S DISCLOSURE

As indicated above, consumer protection appears to be a clear goal of the new condominium statute. Ohio also modified its “Residential Real Property Disclosure Form” to include a specific question that sellers must now answer about special assessments.

Purchasers and their real estate agents will clearly want to know if an association is funding reserves or if the association is voting annually to waive or “under-fund” reserves. Many believe that paying a slightly higher fee monthly and fully funding reserves will make a unit much more marketable.

Unlike the past, where the board alone enacted a budget, Ohio’s new condominium statute requires the entire ownership be involved on a vote to waive reserves. If the board does not enact a budget fully funding reserves and the majority of the voting power of an association votes to waive reserve funding, seller disclosure issues clearly arise. You can bet that the odds will now change in favor of the purchaser when playing “condominium roulette” if the seller fails to disclose to the purchaser the lack of reserve funding.

Real estate agents representing purchasers are, as a precondition of sale, now reportedly not only asking sellers for the Declaration, Bylaws and handbook of rules, but are also asking for a copy of the association���s reserve study. As a result, boards are well advised to provide a copy of the reserve study to all current owners.

NEW LAW HELPS OWNERS

With the enactment of House Bill 135 last summer, the Ohio legislature has attempted to greatly reduce the need for associations to levy special assessments by necessitating the funding of reserves absent a vote to waive the requirement. The new Section 5311.081(A)(1), therefore operates in pursuit of fairness. It will cut down on situations in which owners are “hit” with special assessments unexpectedly and without knowledge, but it also includes a method for associations either unwilling or unable to fund reserves to waive the requirement. As a result, all boards are required to make a choice: either 1) adopt a budget that provides sufficient reserves to avoid special assessments (pay a little more now), or 2) obtain a majority vote of the ownership waiving the reserves required for that particular year (and pay a lot more later).