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Legislative and Case Law Update 2017

Case Law

In Madden v. Scott, IL App Ct 1162149, August 11, 2017 a dispute arose between two units over the use of a front vestibule. The Appellate Court affirmed the lower court finding the existence of an easement

The parties shared a common closed front vestibule with most of the vestibule in Unit 1's space. That space had a front entry and Unit 2 had been using it for over 20 years. After the 20-year period the then owner of Unit 1, locked the entry. Unit 2 took Unit 1 to court claiming they had an easement to enter the front door. Unit 2 presented 3 different theories for the easement: a prescriptive easement because they had been using the vestibule for over 20 years, an express easement provided for in the condominium declaration, or an implied easement of necessity for ingress and egress and Unit 1 counterclaimed, seeking a declaration that they owned the area within their property lines.

The trial court found both an implied and a prescriptive easement for the benefit of Unit 2. The Court went on further to bar Unit 1 from interfering with Unit 2's use of the vestibule and ordered that both owners have keys if the door is to be locked. The court then ordered that the easement was to run with the land and forever bind all owners of the 2 Units.

Unit 1 appealed, based on the fact that Unit 2 had 2 other doors, therefore the use was not essential. The Appellate court disagreed. It found among other things, the entry necessary to fully enjoy the property and that Unit 2's use had been uninterrupted, exclusive, adverse and continuing for over 20 years. The court further concluded even though the property was a condominium, there was no reason to depart from age-old easement law analysis.

In Country Club Estates Condominium Association v Bayview Loan Services LLC 2017 IL App (1st) 1162459, August 8, 2017 a condominium association filed a lawsuit under the Forcible Entry and Detainer Act against an entity that purchased a unit through a foreclosure sale.

In this case unlike the above, the Appellate Court holds otherwise, and adopts the finding in 1010 Lake Shore Drive. The Purchaser herein had not made any payments for 7 months after taking title and did not make payment until 2 months after trial began. The Court held that Section 9(g)(3) requires prompt payment after acquiring the property and what went on further to say that in the absence of extenuating circumstances (unable to reach or get a reply from the association) it is expected that payment is tendered the month after purchase.

In Astor Plaza Condominium Association v. Travelers Casualty and Surety Company of America, Ill. App. Ct. Jun. 30, 2017, the Appellate Court held that the insurer that issued a directors and officers' liability insurance policy was obligated to defend persons sued for an alleged breach of duty, even though they held no official association position during the policy term.

A unit owner voiced concerns to the board, including problems with windows and balconies, lack of meeting notices and access to meeting minutes. Later another unit owner invited all owners to meet at his home to discuss the need to appoint a new board of directors because previous directors had moved. At a subsequent meeting, building renovations were discussed and the needed financing. The owner raised the issue of whether the financing would impact owners without mortgages. Later the board re-designated the window frames and balconies as limited common elements and informing the owner's it would be their responsibility to maintain and repair.

The owner sued the association and the directors, both individually and in their official capacities. Two years of legal maneuvering ensued. The insurer attempted to escape responsibility for the initial and subsequent claims.

The key question on the insurance issue was whether the allegations gave rise to coverage, not whether the allegations are true. The appeals court rejected the carrier's claim that the court only has to concentrate on the final amended complaint to determine whether the insurer was obligated to defend against it. An insurer may either defend under a reservation of rights or seek a declaration that there is no coverage. If it fails to take either step, the insurer is barred from asserting any policy defenses if it later turns out that the insurer wrongfully denied coverage.

The association argued that the policy was ambiguous because the association was not specifically excluded from coverage. The appeals court disagreed, finding that the policy clearly said the insurer would pay the directors or officers obligations if their wrongful acts resulted in a claim for money damages. It did not mention claims brought against the association.

In Lake Point Tower Condominium Association v Waller, IL App (1st) 1622072, June 28, 2017 a condominium association filed a lawsuit under the Forcible Entry and Detainer Act against a unit owner to obtain unit possession.

The unit owner filed a motion to dismiss stating that the board had not taken a vote to proceed as directed by Palm and that the manager's authority was improper. During the trial the association held a meeting and confirmed the vote to proceed with filing a claim. The unit owner argued that there was no authority in the declaration and therefore the vote could not properly be approved. The Trial Court agreed, would not allow the Association to amend its complaint, and then dismissed the Association's complaint with prejudice.

The Association appealed. The Appellate Court following the Forcible Act and the topical case of North Spaulding Condominium Association v Cavanaugh found the Association need not vote at an open meeting to initiate litigation and that the Illinois Condominium Property Act provided no restriction on a board's delegation to a property manager to initiate collection.

In North Spaulding Condominium Assoc v Cavanaugh, 2017 IL App (1st) 160870 a condominium association filed a lawsuit under the Forcible Entry and Detainer Act against a unit owner to

obtain unit possession for failure to pay assessments. Unit owner defended claiming the association was not entitled to attorney's fees for defending counter-claims or for defending the management company.

Citing only the statutes involved, the Appellate Court broadly construed §9.2(b) of the Condominium Property Act (allowing "any attorneys' fees incurred by [an] Association arising out of default by any unit owner") and §9-111 of the forcible entry and detainer statutory provisions (allowing reasonable attorneys' fees in an action based on the failure of the owner to pay his or her proportionate share of common expenses, agreed expenses, or a fine) to include defense of counterclaims against the association. The appellate court found no basis for allowing attorneys' fees for defending a counterclaim against the management company; therefore, it reversed the fee award and remanded the case to the lower court with instructions.

The appellate court went on to further affirm the trial court's ruling that the condominium association, as part of its case in chief in a forcible action, did not have to prove proper notice of an association board meeting and voting taking place at an open meeting to authorize litigation. Second, it affirmed denial of a new trial or other relief finding the court did not abuse its discretion in admitting the Notice and Demand or the account ledger into evidence.

In 5510 Sheridan Road Condominium Association v. U.S. Bank, 2017 IL App (1st) 160279, a condominium association filed a lawsuit under the Forcible Entry and Detainer Act against a bank who purchased a unit at a foreclosure sale.

Unlike the Illinois Supreme Court decision in 1010 Lake Shore Drive, the Illinois Appellate Court, First District disagreed with the association and held that Section 9(g)(3) does not set a strict deadline for when payment must be made and extinguished the banks lien. The Court held that the first sentence of Section 9(g)(3) which states "from and after the first day of the month after the date of the judicial foreclosure sale" means only the time when the third-party purchaser must begin to be liable for post-sale assessments. If the legislature intended for Section 9(g)(3) to contain a strict timing deadline, the Court reasoned it would have included a deadline in the statute...

Legislation

Illinois **House Bill 189** is legislation. HB 189 with amendments to several sections of the Condominium Property Act and the Common Interest Community Association Act, was approved and signed by Gov. on Aug. 24 and becomes effective Jan. 1, 2018.

1] Section 9(c)(5) now provides specific means to dispose of a budget surplus, or address a budget deficit existing at the end of the fiscal year "to the extent that there are not any contrary provisions" in the association's declaration/bylaws. For a surplus: (i) contribute the surplus to the reserve fund, (ii) return the surplus to the unit owners as a credit against the remaining monthly assessments for the current fiscal year; (iii) return the surplus to the unit owners in the form of a direct payment to them; or (iv) maintain the funds in the operating account, in which case the

funds shall be applied as a credit when calculating the following year's annual budget. For a deficit to incorporate it into the following years' annual budget. A mechanism is provided for unit owners to reject the Board's decision regarding handling of the surplus or deficit.

2] Section 15 is amended to add additional relief to a unit owner that objects to the sale of the entire condominium property; specifically, an objecting unit owner is now guaranteed to receive at least sufficient proceeds to cover the outstanding balance of their mortgage on the unit, plus certain relocation costs. The amendment only applies if the sale is pending or initiated after January 1, 2018.

3]. Sale of entire condo property. A unit owner who does not vote in favor of such a sale and files a written objection within 20 days after the meeting at which the sale was approved, shall be entitled to receive from the sale proceeds an equivalent to the greater of (i) the value of his/her interest as determined by an appraisal (less the amount of any unpaid assessments or charges due and owing from that owner) or (ii) the outstanding balance of any bona fide debt secured by that owner's interest which debt was incurred by the owner in the purchase or refinancing of the unit owner's interest (less the amount of any unpaid assessments or charges due from that owner). The objecting owner is also entitled to receive from the sale proceeds,

reimbursement for "reasonable relocation costs, determined in the same manner as under the Federal Uniform Relocation Assistance and Real Property Acquisition Policies Act of 1970, as amended, and any implementing regulations under the Act. This change applies to any sale that is pending or commenced on or after January 1, 2018. (Condo Act Sec. 15(a) and (b))

4] Section 18(a) (16) is amended to increase the time in which unit owners may petition the Board to object to contracts between the Association (from 20 to 30 days days); 18(b)(9)(c) a Board member and objecting to the adoption of rules regarding absentee ballots or electronic voting (15 to 30 days) and 18.4 increasing time for unit owners to petition to object to capital improvement expenditures (from 14 days to 21 days).

Section 18.10 is added to require Associations of 100 or more units to use generally accepted accounting principles. See also Section 1-45(i) CICA.

5] Section 19 of the Condominium Property Act changes: a) an owner is no longer required to provide a proper purpose to review documents although the information may not be used for commercial purposes (defined as use for "sale, resale, or solicitation or advertisement for sales or services") or any purpose unrelated to the Association (and to fine an owner for filing a false certification); b) and although previously an owner was limited to "books and records of account" it now includes all books and records of the association, including all account records; c) the documents shall now be delivered within 10 business days, reduced from the earlier 30 days;19(a)(9), (d-5), (e), and (f) and, d) unit owners' addresses. email addresses, telephone numbers and weighted vote are now to be made available to requesting unit owners 19(a)(7),

6] Section 27(a)(ii) is amended to provide that if a mortgage or lienholder is required to approve an amendment the approval is deemed given if no negative response is received by certified mail with in sixty (60) days of issuing the approval request. See also Section 1-20(e) CICA.

7] Section 31 when a unit owner is combining two or more units, the owner may exclusively use a portion of the common elements that is not necessary or practical for use by the owners of any other units without unanimous consent of all unit owners is amended to define "combination of any units" and to clarify when the combination of units diminishes ownership interests of other unit owners, thereby requiring unanimous consent of the ownership.

8] Combinations of units. It is now made clear that if there is a combination of units (being reflected in a amended plat of survey), then the exclusive use of adjacent common elements to and by that combined unit is expressly permitted. Such exclusive use would be as a limited common element, provided that area in question is "not necessary or practical for use by the owners of any other units." Such creation of a limited common element does not require unanimous consent of all unit owners or any other percentage requirements in the declaration/by-laws or any amendment under the Condo Act apart from Section 31. (Condo Act Sec. 31(a), (e) and (f))

HOUSE BILL 3359 (now Public Act 100-0173, effective January 1, 2018) changes a "forcible entry and detainer action" to "eviction action". The term "eviction" replaces "terminate the right of possession" and "eviction order" replaces "judgment for possession". The Illinois Supreme Court is working on a uniform residential eviction form for statewide use.

SENATE BILL 885 (now Public Act 100-0416, effective January 1, 2018) Repeals the Dwelling Structure Contract the Dwelling Unit Installment Contract Act and replaces them with the "Installment Sales Contract Act" , and changes the Condominium Property Act's reference to "installment contract" to "installment sales contract" (as defined in the new statute); these sections of the Act deal with the ability of contract purchasers to be counted toward a quorum for membership meetings, voting in election of board members and serving on the board of directors (manager), unless such rights are reserved in writing by the contract seller. This change affects condominium and master associations. To determine whether an installment contract qualifies for this treatment, the association needs to check the definition of "installment sales contract" under that new Installment Sales Contract Act. (Condo Act Sec. 18(b)(11) and 18.5(e)(5))

NEW FHA OWNER OCCUPANCY REQUIREMENTS

The U.S. Department of Housing and Urban Development, recently published Mortgagee Letter 2016-15 modifying the owner occupancy requirements for condominium associations seeking FHA approval. With the adoption of this letter ruling condominium associations with owner occupancy rates as low as thirty-five percent (35%) may be eligible for FHA approval, provided they meet certain additional requirements.

Specifically, a condominium association with an owner occupancy rate between thirty-five percent (35%) and fifty percent (50%) may be eligible for FHA approval if it meets the following additional requirements:

1. The association's financial documents for the previous three (3) years (i.e. budget, balance sheet, inc & exp statement) and to insure funding in place of replacement reserves for capital expenditures and deferred maintenance of at least twenty percent (20%) of the association's total annual budget.

2. No more than ten percent (10%) of the total units in the association may be delinquent by more than sixty (60) days on assessment payments to the association.

3. The association must apply for FHA approval through the HRAP process.

With HRAP the association submits its application directly to a HUD office. Associations with at least fifty percent (50%) owner occupancy rates may continue to apply for FHA approval through the DELRAP process, with an authorized lender.

HUD DISCRIMINATION RULES

The U.S. Department of Housing and Urban Development ("HUD") in September 2016 issued its final regulations regarding housing discrimination and with it the responsibility placed upon a community association to investigate and address all relevant housing-related harassment claims of a protected class member by another resident. A protected class includes race, color, national origin, religion, sex, familial status and disability/handicap. This was not an issue in the past, it being the belief that it was not in the association's duty to intervene where the association was not involved in the harassing behavior. Now, the association's failure to act in the following circumstances and allowing it to continue may be found to be a contributing factor in creating a harassing or hostile living environment leading to housing discrimination. Under 24 CFR § 100.7 holds the housing provider (association in this case) liable for:

1. Failing to take prompt action to correct and end discriminatory housing practice by its employee or agent, where it knew or should have known of the discriminatory conduct;
2. Failing to take prompt action to correct and end a discriminatory housing practice by a third party, where it knew or should have known of the conduct and had the power to correct it; and
3. Vicarious liability for a discriminatory housing practice by its agent or employee, regardless of whether the housing provider knew or should have known of the discriminatory housing practice.

A "hostile environment" is defined as unwelcome conduct that is sufficiently severe or pervasive as to interfere with the provision or enjoyment of services or facilities. The new rule indicates that if a written or verbal complaint of discrimination is received and the notice is "severe or pervasive enough to create a hostile environment" based on the "totality of the circumstances," there may be a duty to get involved. "Prompt action to correct and end" a discriminatory housing practice means taking every action available to the association to end the discrimination until it stops. When it comes to third parties, the association's "power to correct" will depend upon the extent of its control or other legal responsibility for the third party. The "totality of the circumstances" includes: (1) the nature and context of the conduct; (2) the severity, scope, frequency, duration and location of the conduct; (3) the relationship of the persons involved; and (4) whether the conduct was sufficiently severe to create a hostile environment.

https://www.federalregister.gov/documents/2016/09/14/2016-21868/quid-pro-quo-and-hostile-environment-harassment-and-liability-for-discriminatory-housing-practices

Action to end the discrimination by a third party including all residents and all contractors and employees hired by the association must be prompt, and the association must use all means available to end the discrimination. This includes notices of violation, monetary charges, suspension of privileges, and litigation to seek injunctive relief against the offending resident. When involved in disputes between owners the association may be required to file an injunctive lawsuit to stop the conduct of one resident towards another. And, although the association is only responsible for third parties over which it has some control or legal responsibility, all residents in the community and all contractors hired by the association are in this

category. The real danger of a harassment cause of action is that unhappy residents may take to filing this type of claim whether there is a foundation for it or not.

If an owner believes that he is being treated in an intimidating manner because residents of another race are getting preferences he is not, the association might face a claim. Your association's security guards, board members, managers, enforce the rules governing use of the common areas more strictly against renters and children, the association may be open to a claim. More troublesome is the liability that may arise against an association if a third party is discriminating against one of its residents in the provision of services or facilities of the association. If one resident is harassing another resident at the pool, rec room, common areas based on race, the association can be held responsible if it fails to promptly correct and end the discrimination. Further the aggrieved owner does not need to complain to the association for the association to be liable, it could be liable for third party discrimination it knows or should have known about. If a board member or lifeguard observes the harassment at the pool, or the doorman at the front desk or the guard in the rec building and the association takes no action to end the discrimination, a claim is possible.

Whether the conduct rises to the level of "severe or pervasive enough to create a hostile environment" is at the outset a factual inquiry. To protect the association and allow it the defense of exercising its best business judgment and considering the seriousness of these types of matters, the association should immediately contact its counsel to assist with the process. Moreover, HUD suggests that an association:

- Educate board members, employees and managers about the FHA and the types of discrimination about which they should be aware and on the lookout for;
- Develop and publish anti-discrimination policies for the association;
- Act promptly to address complaints from residents;
- Mediate disputes between residents; and,
- Use enforcement provisions under bylaws to correct and end discriminatory conduct.

INSURANCE - D&O CLAIMS

Important:

- Any suspicion of possible claim must call agent timely.
- Any written notice of a possible claim or filed claim need to report to immediately.
- If the claim arises out of willful-wanton, call company for advice, may have duty to defend but not indemnify.
  See Astor Plaza Condominium Association, supra.
- Is there a business judgement defense?

Eg: Board passes 180,000.00 special. Several owners sue. Judge finds business judgement rule to apply. Board relied on reserve study that said work was needed and attorney gave go ahead.

Red Flags:

- Adverse contact from prior board member
- Service animal issues
- No turnover of board
- Long term board coupled with manager issues
- Lack of business judgement documentation
- Problem with doorperson
- Voting and representation issues
- Rules on rentals
- 3dp agreements

Good Practices:

- Respond to records or other requests timely
- Keep records for every request
- Maintain and keep records needed to support a business judgment defense
- Keep property maintained- fiduciary responsibility
- Train board and management regarding use of information and protecting the attorney-client privilege

Eg: A manager was tasked to forward an email to opposing counsel in a matter, not paying attention, she forwarded the email. Unfortunately, it was part of a private 3-page email chain. Now in the hands of opposing counsel, all privilege is lost.

BULK SALES UNDER § 15 OF THE ILLINOIS CONDOMINIUM PROPERTY ACT

The ultimate and pivotal question in a bulk sale under §15 of the Illinois Condominium Property Act (the Act) which a board should look to answer is – does the benefit of selling outweigh the actual cost of not selling. Finding the answer to this question prior to offering the property for sale, provides an overall approach which covers the myriad interests of all the parties and does not fall prey to the interests of any one person or group.

Bulk Sales although permitted by sect 15 of the Act are thrust upon associations without a road map to provide guidance for boards in furtherance of their fiduciary duty to the owners in the process. Each bulk sale, unless undertaken in an orderly manner, ends up in some form being a tug of war between the developer/builder and owners, or the owners and the board, or owner-occupied owners and investors or underwater owners vs the other owners. Without a process, the endeavor opens opportunities for conflicts of interest to arise.

If an orderly pre-process system is not employed it is my suggestion that any board member that falls into a category where the benefit to the board member is greater than to other members, or an attorney that represents the association, but also appears to be representing any individual interests of the board members or a board member or other owner's interests, that the parties step aside from representing the association. In each of these cases the financial gain is enough to create the appearance of a serious conflict of interest for board members and the association's attorney.

Every effort should be made to follow a transparent and owner supported procedure to avoid any appearance of a conflict of interest, loyalty, and a breach of duty and following the below suggestions does just that. Although developer's and sales agents can be overbearing and aggressive at times, when an association falls into chaos one can generally look to the board, manager, or attorney, if any, for the outcome. The developer or agent is only the vehicle that brought it to your door. That is why no matter who is in charge a roadmap is crucial and conflicts must be kept in check. The best place to start any issue critical to the members and requiring a member vote is with a survey and in this instance, a due diligence document collection and building inspection.

The survey is intended to illicit answers to determine the will of the majority, under what conditions and what if any issues will arise in attempting to close the sales allowing the board to determine many of the important initial factors in an organized, time saving and practical manner. The other information to be gathered will help determine what a buyer should be willing to pay for the building and assist the board in determining how the Net Sale Proceeds should be allocated to maximize the vote in favor of the sale (Note: Section 15 <u>does not require</u> that percentage interests or any other formula be used to allocate the proceeds of sale among the unit owners.)

Agreeing on how the net proceeds of the sale will be distributed is a significant issue. What if after completing this pre-work, it is determined, that the answer to the opening question points against selling, better to learn it in the beginning rather than months later. False starts lead to wasted time, emotional energy, sometimes excessive costs, and conflict. On the other hand, an association underwater with massive capital repairs and replacements confronting them might relish the opportunity to sell.

These are the smoothest and quickest best practice vehicles to gather the needed initial information prior to presenting the information to the association and taking a preliminary vote to proceed or whether to bother with one at all. No one can, neither should they, force an association's timetable and

a board that allows the developer or another board member or a group of owners to have that type of control is not performing its duty. In addition, doing it any way but orderly may lead to serious ramifications.

A survey should include questions/items and identify issues such as:
1] If owner known does owner want to sell, determine ownership if difficult contacting or identifying owner where deceased/incapacity or if owned by lender;
2] Do they have clear title, clouds on title must be cleared to close;
3] If a preliminary vote is reached will the owner cooperate, will the owner cooperate at the final vote if 75% vote reached, if not, why not;
4] What is the purchase price paid by the owner and the cost of significant rehab work done on the unit;
5] The amount outstanding on mortgage liens and other liens with respect to the unit;
6] If an investor owner, financial information on tenant should be gathered, including whether there are any delinquencies or defaults or alleged defaults by the tenant or any complaints or claims by the tenant;

A due diligence inspection and document collection should include:

1] Copies of all contracts, how long-term contracts will be handled as well as any permits and licenses;
2] A building inspection and inspection of all units to determine current work needed and the remaining useful life and cost to replace systems and facilities, such as heating, HVAC, plumbing, etc.;
3] Any open efforts to obtain reductions in real estate taxes;
4] A current report of unit assessment payments, delinquencies, and the status of any collection efforts;
5] Balance sheets and financial statements for the last two fiscal years;
6] Information regarding open litigation, or disputes between the association and a third party or a unit owner, or between unit owners known to the association.

After the information is organized it should be shared with the members for an initial member meeting and then a second meeting to address the issues that were overlooked at the first meeting. A preliminary vote can be taken at this meeting and if it seems that more owners than not are in favor of a sale other meetings can be called to present to owners an offer that should include the terms on which the building would be sold and how the net proceeds of sale would be distributed. The proposed offer should include a proposed form of sale agreement which will be used to effectuate the transaction with the selected buyer.

The offer should set out at least the minimum net sales proceeds which the association will require after all costs, fees and transfer taxes have been paid and, the minimum amount of money an owner will receive when the sale is completed, plus or minus prorations. How excess proceeds, if any, should be distributed must be discussed. This is only the beginning and hopefully it is clear how important process becomes to a reasonable and hopefully conflict free outcome. In the end regardless of the required 75% vote needed, participation of 100% of the owners is required for the processing of individual unit paperwork and closing.

Many owners suffered at the hands of the market, purchasing in 05-09 because most did not due a true due diligence inquiry and investigation beforehand. So, before the board jump's in with both feet first, slow down, take it one step at a time and perform the due diligence review the exercise of reasonable business judgment requires and the duty of undivided loyalty mandates.

Sold

Bel Harbor	207 units	$51.5 million
Buena Park	101 units	$16.2 million
Clark Place	133 units	$35.0 million

Possible

Century Tower	293 units	$60 million
Kennelly Sq.	268 units	(each unit is assessed a special for $49,000 for capital repairs)
Parkview Tower	21 story	

Failed

River City	448 units	only 58% appvl

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2-16-16 A summary From the SLOOP (South Loop) Blog-

A Cautionary Tale of "Deconverting" Condos to Rental, 448 units River City Condos

- After 75% vote on bulk price told done deal followed by a walkthrough of all the units
- Upgrades credits >20,000
- Offered discounted rent based on pp then random list of rent backs
- Then final vote to ratify
- Day before vote, new offer submitted drastically lower (wait till everyone almost ready to move and gave them the shaft) and that at least 50% had to rent back @ non-discounted price
- New vote didn't pass, and the whole process went down the drain

Lesson Learned- (1) process takes months during which no one can sell, start new leases, or basically do anything (2) get everything in writing (3) walkthroughs and developer involvement should not take place until a firm bid is in place.