

HOMEOWNERS' ASSOCIATIONS AND RESTRICTIVE COVENANTS

PRESENTED BY:
CHARLES J. HEINY
ATTORNEY AND CERTIFIED PUBLIC ACCOUNTANT
CHEINY@HALLERCOLVIN.COM

HALLER & COLVIN P.C.

ATTORNEYS AT LAW
444 EAST MAIN STREET
FORT WAYNE, IN 46802
TELEPHONE: (260) 426-0444
www.hallercolvin.com

Key Documents

- The declaration.
- The Articles of Incorporation -- Homeowners' Association typically organized as an Indiana non-profit corporation.
- The Bylaws.
- The rules and regulations (if applicable).

Declaration of Covenants

- When a parcel of land is subdivided, the person that is making the subdivision typically records a declaration which imposes restrictions on the use of the land.
- The Declaration, which is usually cross-referenced in the plat, states that its provisions “run with the land,” thereby creating obligations which are binding not only upon the original purchasers of the homes or lots within the community, but also upon all successors in title.

Declaration of Covenants – cont'd

- Plus, a purchaser cannot disclaim membership in the Association. Purchaser has constructive notice.
- Similarly, membership in the Association automatically ceases when a person no longer is the owner of a home or lot within the community.
- Most declarations state that only legal owners of record constitute the community association's membership. Thus, renters and land contract purchasers are typically excluded.

The Homeowners' Association

- The declaration typically provides for the establishment of a Homeowners' Association.
- Developer typically retains control over Homeowners' Association through the build-out of the project.
- The declaration typically provides that each home or lot is a member of the Association and has one vote on matters coming before the members of the Association for action.

Typical Form of Operation for Homeowners Association

- Most common approach is a non-profit corporation formed under Ind. Code § 23-17-1-1, *et seq.*
- The Indiana non-profit corporation act identifies three different types of non-profit corporations:
 - public benefit;
 - religious; and
 - mutual.

Typical Form of Operation for Homeowners Association – Cont'd

- The mutual benefit corporation is the appropriate choice for Homeowners' Association. The purpose of the corporation and its existence is for the benefit of the members, the property owners.
- Sometimes you see an unincorporated Homeowners' Association. Legal liability exposure in the case of unincorporated Homeowners' Associations?

Articles of Incorporation

- The non-profit act requires six items to be included in the Articles of Incorporation:
 - The corporate name;
 - A statement identifying the type of non-profit corporation, such as a mutual benefit corporation;
 - The name and address of the registered agent;
 - The name and address of each incorporator;
 - Whether or not the corporation will have members; and
 - Provisions concerning the distribution of assets on dissolution.

Articles of Incorporation – cont'd

- The Articles of Incorporation establish the basic parameters of a community association as a non-profit corporation.
- Compare: The Bylaws provide much greater detail on many important issues.
- Member power generally limited to election of directors.

Bylaws

- The Bylaws serve as a frame work for the internal administration and operation of the Corporation.
- Bylaws typically contain provisions for amendment of the Bylaws.
- The fundamental purpose of the Declaration is to establish the legal interest in real estate and the right of an owner for use of the real estate. The procedure for amending a Declaration typically requires a super majority vote of the owners. Bylaws, on the other hand, often times permit amendment on a majority vote or something much smaller than required to amend the Declaration.

Bylaws – cont'd

- The Association's Bylaws set forth many important administrative and operational procedural requirements which are normally associated with corporate law.

Bylaws – cont'd

- The Bylaws typically address:
 - The date of the annual meeting;
 - The number of Directors;
 - The terms of Directors;
 - The qualifications of Directors (such as require them to be owners);
 - The powers and duties of the Board;
 - Quorum requirements;
 - Notice requirements;
 - The use of proxies;
 - The agenda of the annual meeting;
 - The officers;
 - The committees; and
 - Insurance requirements.

Bylaws – cont'd

- Bylaws accordingly provide many of the details necessary for the proper administration of the Homeowners' Association.

Obligation to Pay Dues or Assessments

- In most Declarations, the obligation to pay is twofold.
- First, the dues or assessments are the personal obligation of the owners.

Obligation to Pay Dues or Assessments – cont'd

- Second, the dues constitute a lien against the property which is subordinate only to the first mortgage and real estate taxes.
- Typically, declarations provide that dues are collectible with costs, including reasonable attorney fees.

Number of Votes per Home

- The Non-Profit Act contains a default provision that states that a Member is entitled to one vote on each matter voted on by the Members.
- The Act also provides that unless the Articles or Bylaws provide otherwise, if a membership is in the name of two or more persons and if more than one person votes, the vote is to be divided on a pro rata basis.

Number of Votes per Home – cont'd

- The governing document for Homeowners' Associations typically state that if more than one person is the owner of a home, then all such persons or members have only one vote for that home which is to be cast as they among themselves determine.

Federal Income Tax

- If your Homeowners' Association is a non-profit corporation, that does not mean that it is immune from having to file a tax return and pay taxes. However, very few HOAs qualify for tax exempt, 501(c) status.
- This leaves the majority of community associations with the obligation of paying tax on their non-exempt income.

Federal Income Tax – cont'd

- Just because the previous board may have failed to submit a tax return does not absolve the Homeowners' Associations of the responsibility of filing a return for the current year, and you may be asked to submit returns for the previous years as well. The Homeowners' Association federal tax return (Form 1120-H) is due 75 days after the close of your tax year. For Homeowners' Associations that operate on a calendar year, your tax return must be filed on or before March 15th.

Federal Income Tax – cont'd

- Regardless of the size of your community, it's non-profit status, or lack of income from anything other than assessments, all Homeowners' Associations should file the required 1120-H tax return. Assessments and fees paid by members are not taxable, but interest income and any income paid to the Association by non-members is taxable.

More on Covenants

- A restrictive covenant is an express contract between grantor and grantee that restrains the grantee's use of his land.
- Law has long recognized enforceability of private covenants.
- Covenants control many aspects of land, including what may be built on the land (e.g., fence or above ground pool), how the land may be used (private or commercial), and alienability of the land.

More on Covenants – cont'd

- Restrictive covenants are used to maintain or enhance the value of land by reciprocal undertakings that restrain or regulate groups of properties.
- These covenants are common in condominium or other “common-interest” housing subdivisions.

More on Covenants – cont'd

- Prior to selling the first unit or lot, the subdivision or condominium owner creates a declaration or master deed that contains all of the restrictions.
- Property owners who purchase their properties subject to such restrictions give up a certain degree of individual freedom in exchange for the protections that result from living in a community of reciprocal undertakings.

More on Covenants – cont'd

- Restrictions found in a declaration (like those found in a master deed) are clothed with a very strong presumption of validity which arises from the fact that each individual unit owner purchases his unit knowing of and accepting the restrictions to be imposed.
- Restrictive covenants function identically in planned subdivisions and condominiums and function identically regardless of whether they are found in a master deed or a declaration.

More on Covenants - Rental Restrictions

- Condominium and Homeowners' Associations frequently adopt no-lease covenants that bar rental of units and forbid absentee ownership.
- These covenants are adopted to address owners' concerns "about the negative effects of high resident turnover and renters' perceived lack of attention to the property."

More on Covenants – Rental Restrictions – cont'd

- Some empirical data may validate these concerns. A California study showed that “[a] high number of leased units (over 30%) can impair significantly the market position of the subdivision.”

Landmark Indiana Decision on Rental Restrictions

Villas West II v. McGlothlin

- On May 15, 2008, the Indiana Supreme Court issued a decision that is a major victory for community associations of all varieties. The case pertains to covenants that totally ban rentals.

Landmark Indiana Decision on Rental Restrictions – cont'd

- The case of *Villas West II of Willowridge Homeowners Association Inc. v McGlothin* began when the association for a duplex-style community sued a homeowner who was renting her home.
- The covenant stated “For the purpose of maintaining the congenial and residential character of Villas West II and for the protection of owners with regard to financially responsible residents, lease of a Dwelling by an Owner shall not be allowed.”

Landmark Indiana Decision on Rental Restrictions – cont'd

- The owner countersued by claiming that the rental ban had a greater impact on minorities and therefore constituted a violation of the racial discrimination laws.
- At the trial, the homeowner's expert offered statistical evidence to show that a total ban on rentals had a "disparate impact" on minorities as compared to Caucasians.

Landmark Indiana Decision on Rental Restrictions – cont'd

- The Association introduced substantial evidence that there were very legitimate reasons for rental restrictions that had nothing to do with race.
- The trial court judge found that the Association was in violation of the fair housing laws, and the Indiana Appellate Court upheld that decision in January of 2006.

Landmark Indiana Decision on Rental Restrictions – cont'd

- In fact, the lower courts went so far as to hold that the rental ban was “subterfuge for excluding minorities from renting homes.”

Landmark Indiana Decision on Rental Restrictions – cont'd

- The Indiana Supreme Court ruled that the trial court and appellate court decisions were wrong, and overturned them. The Justices, in a 3-2 decision, held that there were legitimate, non-discriminatory reasons for the leasing prohibition covenant and that both the evidence in this case and common sense tell us that owner-occupants have a much better incentive than tenants to not only preserve property values, but to actually enhance property values.

Landmark Indiana Decision on Rental Restrictions – cont'd

- The Court analyzed federal laws to determine the proper test to be applied, and then concluded that Villas West II did not violate the Fair Housing Act with respect to the “disparate impact” theory.
- In addition, the Indiana Supreme Court decision made general observations on community associations that bolster a recent trend in decisions issued by the Indiana Court of Appeals that favor the enforcement of covenants.

Significance of Villas West II Case

- Case watched closely all across the country, especially by community association attorneys and the Community Associations Institute.
- This is because: (1) so many associations already have rental restrictions of one sort or another, and (2) this may have been the first case in the United States that specifically addressed the application of fair housing laws to rental restrictions set forth in covenants.

Written Ballots

- The Non-Profit Act of 1991 created a new procedure by which Members of any non-profit corporation can take action without a meeting where the corporation delivers a written ballot to every Member entitled to vote.
- The ballot must set forth a proposed action and give an opportunity to vote for or against that action.

Written Ballots – cont'd

- If the number of votes cast by written ballot equals or exceeds the necessary quorum to be present at a meeting, and if the number of approving votes equals or exceeds the number of votes that would be required to approve the matter at a meeting, then approval by a written ballot without a meeting is accomplished.

Association v. Owner Conflicts

- Declarations usually provide for the Association's right to enforce the covenants against the owner through an action at law or in equity.
- Declarations often times also give the same enforcement right to each individual owner.

Haller & Colvin Neighborhood Association Legal Team



Charles J. Heiny



Robert W. Eherenman

Charles J. Heiny – Bio

cheiny@hallercolvin.com

Charles J. Heiny began his legal practice in 1990. Prior to beginning his legal career, Mr. Heiny worked in Fort Wayne as a tax consultant for a national CPA firm.

Mr. Heiny serves as counsel to both large and small business clients. He has extensive experience in representing business clients in complex commercial transactions, including mergers, acquisitions, and divestitures, as well as extensive experience in assisting clients with their other ongoing business legal needs.

In addition to business and corporate work, Mr. Heiny devotes a significant part of his practice to neighborhood association law matters, estate planning and administration, real estate law, tax law (including tax planning for business transactions, tax controversies, creditor's rights, and bankruptcy law). These practice areas fit naturally with Mr. Heiny's business and corporate practice and his training both in the law and accounting/business.

Mr. Heiny has actively served his profession and his community. He has served as a member of the Taxation Section of the Indiana CPA Society, on United Way Allocation Committees, as a member of the Board of the Anthony Wayne Area Council of the Boy Scouts of America, as Chairman of the Probate Section of the Allen County Bar Association, and as a member of the Allen County Bar Association legal forms committee. He also serves on his church finance council and as president of his neighborhood association.

Memberships: Allen County and Indiana State, and American Bar Associations; Indiana CPA Society; Fort Wayne Estate Planning Society; Taxation Section of Indiana Bar Association.

Education: Indiana University, B.S. (Accounting Major, 1984), awarded with high distinction; Beta Alpha PSI; Indiana University School of Law, J.D. (1990), awarded with distinction.

Robert W. Eherenman – Bio

rwe@hallercolvin.com

Mr. Eherenman is a shareholder in Haller & Colvin, P.C. and has practiced law in Fort Wayne since 1992. He has focused his practice in the area of land use litigation, including zoning permits, rezonings, annexations, development plans, subdivision approvals, and other zoning and land use approvals. Mr. Eherenman regularly practices in front of boards of zoning appeals, plan commissions, and other local land use agencies and has litigated land use issues at the trial court level, as well as in the Court of Appeals of Indiana and the Supreme Court of Indiana. He is the attorney for the Allen County Plan Commission, the Allen County Board of Zoning Appeals, the Fort Wayne Plan Commission, and the Fort Wayne Board of Zoning Appeals. Mr. Eherenman represents several homeowner associations and also presents to the Allen County Homeowners Association.

Mr. Eherenman also practices in the area of general civil litigation, where he handles cases involving real estate matters and commercial law. He has handled appeals in both the Indiana appellate courts, as well as the Seventh Circuit for the United States Court of Appeals.

Education: DePauw University, B.A. (1988), *magna cum laude*, Phi Beta Kappa; Indiana University School of Law - Bloomington, J.D. (1992, *cum laude*). **Organizations:** Indiana State Bar Association, ISBA Land Use and Zoning Section, Allen County Bar Association; Indiana Trial Lawyers Association.