

SUBJECT: Allowing condominium associations to pledge future revenue for repairs

COMMITTEE: Business and Industry — committee substitute recommended

VOTE: 6 ayes — Deshotel, Elkins, England, Giddings, Orr, Quintanilla

0 nays

5 absent — Christian, Gattis, Keffer, S. Miller, S. Turner

WITNESSES: For — Connie Heyer, Texas Community Associations Institute;
(*Registered, but did not testify*: Steve Scurlock, Independent Bankers
Association of Texas; Sandra Denton, Community Associations Institute)

Against — None

BACKGROUND: Property Code, ch. 82 governs the establishing of condominiums. A condominium is defined as real property — whether residential, industrial or other types of use — with portions designated for separate ownership and occupancy and with the remainder, the “common element,” designed for common ownership or occupancy solely by owners of the portions.

A condominium association’s powers include the right to adopt and amend bylaws, set budgets, collect fees from owners for common expenses, file, defend and settle lawsuits, make contracts and incur liabilities related to the condominium’s operations, and maintain and modify the appearance of the condominium. If an association foreclosed on a lien on a condominium and, in turn, bought the condominium at a foreclosure sale, the owner has the right to redeem or repurchase it from the association.

DIGEST: CSHB 2949 would amend Property Code, ch. 82 to:

- allow condominium association boards to pledge future revenues as a lien for loans;
- allow condominium association boards to provide for a reasonable deductible for insurance policies and to pay for the amount of the deductible for repairs; and

- allow property owners a right of redemption for condominiums purchased at a foreclosure sale by a third party.

The bill would amend Property Code, sec. 82.102 to allow a condominium association to pass a resolution to assign the association's future income, including the right to receive common expense assessments and assign lien rights, as collateral for a loan, unless otherwise prohibited by the declaration, articles of incorporation, bylaws, rules, or other restrictions. A favorable vote by 67 percent of all outstanding votes of the condominium association would be allowed to remove such restrictions and authorize borrowing money.

CSHB 2949 would also allow the condominium association board to provide for commercially reasonable deductibles for insurance. Other provisions would require that the costs of repairs or replacement incurred before any insurance proceeds were available be paid as determined by resolution of the board of directors. Any board resolution that authorized these expenses would be considered a dedicatory instrument and be recorded with other property records of the association. Otherwise, the repairs and replacement would be considered a common expense.

CSHB 2949 would grant condominium owners a right to redeem their property if purchased at a foreclosure sale by a third party other than the condominium association. The redeeming owners would be required to pay the purchaser:

- the amount bid at the foreclosure sale;
- interest on the bid amount, calculated at a rate of 6 percent from the date of the sale to the date of redemption;
- any assessments the purchaser paid to the condominium association, and any other reasonable costs, including the costs of maintenance and leasing.

The redeeming owner also would be required to pay the condominium association all assessments due on the date of redemption as well as reasonable attorney's fees and costs associated with foreclosing the lien.

Upon redemption, the third-party purchaser would be required to execute a deed with no warranty to the redeeming unit owner. The right of redemption would not be allowed against subsequent purchasers or lenders unless the redeeming unit owner recorded the deed from the purchaser or

filed an affidavit that the redeeming unit owner had exercised the right of redemption. The third-party purchaser would have the right to collect any rents or income from the property, but the amount would be credited against the redemption amount. The third-party purchaser also could not transfer ownership to anyone except the original owner during the redemption period.

The bill would take effect on September 1, 2009.

**SUPPORTERS
SAY:**

CSHB 2949 would help update state law governing condominium associations and would better reflect actual management practices in the industry. Current statutes limit the ability of condominium associations to raise the funds quickly to pay for massive damage, as occurred with coastal condominiums after Hurricanes Rita and Ike. The bill would provide accountability and flexibility to respond to these kinds of catastrophic events.

CSHB 2949 would address the problems of providing adequate collateral to secure loans for large capital projects by allowing condominium associations to pledge future revenue. Pledging accounts receivables and assigning lien rights on them was not a common practice when the Uniform Condominium Act was passed 16 years ago. Current law is unclear on whether condominium associations would have the right to use future assessments as collateral if otherwise prohibited by the dedicatory documents or the bylaws. The bill would provide an equitable solution to the borrowing needs of the condominium association.

The bill would also help address the change in insurance industry practices, especially after extensive storm damage to property along the Texas coast and elsewhere in the state. The bill would recognize the need to provide for higher deductibles than contemplated when the statute was first adopted. Current law provides that repair or replacement in excess of insurance proceeds and reserves is considered a common expense. The complication is that these expenses to meet the deductible must be paid before the insurance claim is paid. The bill would help resolve the dilemma and allow condominium associations to assess costs of deductibles, which can be in the range of hundreds of thousands of dollars.

CSHB 2949 would close a gap in the current law and provide a right of redemption to a unit owner if that property were sold at foreclosure to someone other than the condominium association. Currently, the owner

has no right to redeem in those situations. The bill would allow the owner to reclaim the unit by paying a reasonable price to the purchaser and would protect the condominium's right to collect the assessments due on the unit.

OPPONENTS
SAY:

CSHB 2949 could have the unintended consequence of allowing condominium associations too much power in allocating costs under the proposed Property Code, sec. 82.111(i). The provision would permit the board to allocate costs to unit owners in any manner it deemed acceptable, but a board arguably could allocate any cost contrary to the cost allocation set forth in the declaration, provided those costs were incurred "before any insurance proceeds are available." Even if the cost were incurred in anticipation of the receipt of insurance proceeds, it would make more sense either to allocate as provided in the condominium declaration or allocate to unit owners who benefit from the cost incurred. The bill should require the board to allocate the costs more fairly among owners who would benefit from the repairs and replacements.

The bill could dilute the potential benefit of allowing the unit owner to redeem a foreclosure purchase by a third party by allowing the purchaser and the condominium association to stack additional fees and charges on the redemption price. These additional amounts could make redemption a right only in theory.

OTHER
OPPONENTS
SAY:

As proposed, CSHB 2949's amendment to Property Code, sec. 82.102(9) would not accomplish the goal of permitting assignment of future income to secure capital improvements unless prohibited by the condominium's declaration, bylaws, or certificate of formation. Currently, if the declaration or the bylaws or certificate of formation is silent on this issue, the board cannot assign future income without amending the document. The bill would mirror current law in requiring consent of 67 percent of all owners. The process of amending the various documents would not necessarily be any easier under CSHB 2949 than it is under current law.

NOTES:

The substitute differs from the bill as filed in changes to the process by which the condominium association would be able to obligate future revenue to borrow money; allowing for insurance deductibles to be set at a rate considered commercially reasonable; and requiring that the third-party purchaser of a foreclosed unit provide a deed with no warranty, compared with the original bill's requirement that a special warranty deed would be

provided.