

RENTAL RESTRICTIONS - ARE THEY LEGAL? ARE THEY GOOD ... OR BAD ... FOR THE COMMUNITY?

This month's topic is a hot one. Lots of board members in condominium and townhome-type homeowner associations ask about lease limitation restrictions. Boards want to know if they can restrict leasing in their developments. Most recognize that they need to seek approval from owners. The desire often arises because of bad experiences with rented units. Boards often find that there are more problems with rental units than owned units. Many are aware of problems related to financing with high percentage of rentals but do not exactly understand why. The higher the rental percentages, the more problems, it seems.

Here are some answers to questions that come up, in simple terms:

What are common lease limitations or rental restrictions?

A lease limitation provision might be based on any of the following (or maybe someone out there has come up with something more creative):

- Limit on number of units/lots that can be leased at one time, usually ranging from zero to 30% or 40%.
- Prohibition on leasing for the first year, two, or three after purchase.
- Limit on term of lease, for example – one year minimum.

The thinking behind these restrictions is that they promote residential living, by deterring investor purchasers. Resident owners that plan to continue to reside in the property tend like this idea very much. The more they are bothered by renters, the more they like the idea. Resident owners that plan to "move up" in the coming years and want to keep and rent their properties out would not be crazy about the idea that they could be prevented from doing so. Investors and leasing owners would probably not like the idea very much, unless they were guaranteed the right to continue to rent the properties under the new restrictions (which could be done through "grandfathering" – see below).

What are the arguments for these kinds of restrictions?

One simple truth that many people believe and that many experience is that high percentage rental communities tend to have many more problems than lower percentage rental communities. Way back in 1985, the last time I know of that any State study was done, the California Department of Real Estate commissioned a study and that is what the study showed.

Another simple truth is that it can be harder to get conventional financing for properties in common interest developments because the largest purchasers of residential loans in the country – namely FNMA and FHLMC (more commonly known as Fannie Mae and Freddie Mac – ***sounds like something right out of the Flintstones***) have limits on purchasing loans in high percentage rental communities. So, if your HOA is over 30-40% rentals, and it becomes especially apparent if it gets over 50% rentals, the financing gets tougher to find, through conventional methods at least. However, see below for more on this in today's market place.

Another simple truth is that renters are generally more transient than residents. It is a given that the transient part of society tends to have less interest in taking care of the real estate they occupy for temporary purposes than the buyer who has crossed the line into property ownership and has pride in that "piece of dirt".

What are the issues and questions about investors in all this?

Investors often have different interests than residents. While some investors take great pride in every piece of property they own, others are only interested in the bottom line – how much rent can they pull in – how little can they spend. There seem to Boards to be many more in the latter category.

If an HOA needs the investor or owner-landlord segment votes to get the percentage of approval needed to pass the restrictive measure, special provisions need to be made to protect these parties so they will not lose their right to lease. Any proposed CC&R amendment could “**grandfather**” all owners currently leasing their properties (which would include investors and those owners who have “moved up” already), or could “**grandfather**” all owners who own units or lots in the development at the time the measure is passed. “**Grandfathering**” everyone that owns does put everyone in the development at that time on the “same plain” and alleviate concerns about being prevented from leasing their property, but obviously, it is harder to keep or bring down the percentage of rentals if everyone is grandfathered. In that case the attrition normally occurs only through sale or transfer of property in the development. Sometimes this latter approach is the only way to get the measure passed. I believe that passage of a CC&R amendment that does not at least “grandfather” those currently leasing (at the time it is passed) is inviting legal trouble. [There are pros and cons to that which have been and will be further explained in the next **CALIFORNIA HOMEOWNERS ASSOCIATION LEGAL DIGEST** and also in an upcoming “Primer”, both of which can be purchased at www.californiacondoguru.com.]

Who gets hurt by the provisions?

The hardest bit of truth is that while the leasing limitation provisions do help keep or lower the percentage of renters in any community, they still can “bite” the innocent. What happens to those who thought the restriction was great until their life circumstances changed, they needed to move away temporarily or permanently, the market went south (what a concept, huh?), and they could not afford to sell? Boards often want to make allowances, and then get into trouble for turning one request down while and approving another.

What kinds of things do suggest variances to the regulations should be granted?

In order to make a lease limitation restriction fair, reasonable, and able to pass court scrutiny, I believe (and this is based on my reading of the cases all around the country and in California), there has to be some kind of hardship provision. This means that if someone is called off to war, and they are going to be doing a duty tour, they should be able to temporarily lease their property during that time! If someone has a medical disaster – either them or a family member – and they need to be somewhere else for a period of time, they should be able to temporarily lease their property during that time! There are those who would disagree even with that. And, of course, there are those owners that might “embellish” or make up such a story when the Board members know it to be less than true.

What are the California Courts doing with this issue?

There are two pending cases that may or may not change during appeal processes, and I will be updating information as I receive it about these cases. Both HOAs involved received favorable judgments in the respective Superior Courts (both southern California cases), and in both cases, the owners challenging the restrictions have vowed to appeal.

What is the California legislature doing with this issue?

AB 2259, a bill that will pass or fail this year, one way or the other, places limitations on enforcing lease limitation restrictions. If approved it would provide protection to owners who are in opposition to leasing restrictions by giving them vested rights (explained below) that except them from approval of rental limitation restrictions by the necessary percentage of members. Owners who live in HOAs that approve the restrictions while they live there can choose not to have the restrictions apply to them.

This is a controversial bill, on a controversial topic. Watch my website <http://www.californiacondoguru.com> for updates on BETH's BLOG and check out the current article entitled: "Lease Limitation Amendments - Are They Legal In California?" After all is said and done, if an HOA wants to restrict leasing and have those restrictions apply equally to all owners, with all that is going on, there are indications that sooner is better than later – as the bill, if passed into law will change things.

How does a board go about approaching the owners?

It is not wise to propose such an amendment without educating the owners about the pros and cons and reasons for considering it. If you want information to send out, it's free on my website. If you want to survey the owners, be sure to send them information about the amendment so they are answering the survey from an educated perspective, and here is a survey you might consider sending.

SAMPLE SURVEY (STRAW POLL-NOT A VOTE ON AMENDMENT)

Would you be in favor of limiting leasing (renting out properties) in the development?

Yes, No, or Comment:

Would you like the Board to schedule an informational meeting about this?

Would you like to have an attorney come to an Association meeting to answer questions?

Are you leasing your unit at this time? It is important for us to know because the Board needs accurate information on the current number of rentals to choose an appropriate percentage limitation that takes everyone's interests in the community into consideration.

Do you think all owners currently leasing should be "grandfathered"(exempt from the limitation)?

Do you think all current owners should be "grandfathered" – exempt from the limitations - (this would take longer to have a beneficial effect as it would affect only purchasers of units after the amendment becomes effective).

Do you have any other comments? We are interested in your opinions and thoughts.

We encourage you to contact your local banker and ask if the number of rentals in a common interest development affects financing for a new buyer or refinancing for a current owner.

This article provided by:

Beth A. Grimm, Attorney, is recognized by many as a leading homeowners association attorney and resource for information on legal and practical matters related to homeowners associations in California. Through her blog, written books and published materials she works to educate the masses, recognizing there is a serious shortage of available information in California on solving HOA problems and understanding the law that governs boards and members.

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