Eric J. TenBrook, LLC

05-05-2011

Via e-mail

Board of Directors
Clearmeadows Community Assn.
c/o The Management Group, Inc.
15350 SW Sequoia Parkway, Suite 200
Portland, OR 97224

Re: Leasing and Hardship Relief

Dear Board Members:

You have asked me to provide you some advice regarding leasing and hardship relief, specifically surrounding the parameters that the Board may work with, and legalities involved.

Near-Absolute Restriction on Leasing in CC&Rs, With Hardship "Escape Valves"

The Declarant adopted your CC&Rs with a near-absolute restriction on leasing, for the purpose of promoting a primarily owner-occupied development. Particularly when adopted at inception of the community, this sort of restriction is not contrary to law, and has a rational, non-discriminatory basis: the support of property values.

The restriction provides that the Board may allow leases for hardship cases, and gives some examples, which are not exclusive. This authority provides the Board with an "escape valve" to deal with new conditions of a temporary nature with a great deal of flexibility, as discussed below. I have attached the relevant CC&R provisions to this letter so that you may refer to them in conjunction with this discussion.

Many of the communities in the Fisher's Landing area have similar to identical lease restriction clauses. These communities may vary in the text of the hardship policies they've adopted and the range of situations that are considered hardships, and thus may differ at that level even though the primary lease restriction is nearly identical.

However, in the economic conditions we are facing with the housing market collapse and recession, some problems are revealed in these types of lease prohibitions, and it may in fact support property values to allow leases in order to prevent or ameliorate the effects of foreclosures.

I have often suggested to Boards that failure to find a reasonable means to allow a hardship lease in this particular economic climate might result in having to revisit the owner issue through a collection action – to an uncertain end.

Does the Board Have the Obligation to Enforce the Lease Restriction Even in These Economic Times?

If I were to summarize one group of questions raised in the Board's concerns, it boils down to – "are we really obligated to enforce this Leasing restrictive covenant in these economic times, even if it means that some

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members have an increased risk of default on their mortgages/increased foreclosure risk because they cannot cover their losses through lease income?"

At the outset, let me be very clear that the Board has an affirmative duty to enforce those provisions of the CC&Rs that are mandatory, and the Association and, potentially, individual Board members *could* be held liable for not doing so. There is nothing inherently illegal about the current lease restriction that would overcome this obligation (such as if it were patently discriminatory on the basis of race or religion). If a CC&R appears to be unpopular, or unhelpful to the community, the Board could propose an amendment to the membership to remove or modify it and the voting membership will, through the political process, provide guidance on their sentiment about the need for lease restrictions.

That said, as discussed below, the Board has some fairly broad discretion with respect to hardship. If the Board believes that the economic situation is temporary, it may choose to expand and contract hardship rules in response to the current economic realities rather than amend the declaration. As discussed further, while the Board should not use this discretion to effectively "gut" the entire lease restriction, I am of the opinion the Board can address current economic impacts to members and allow, on a case-by-case basis, according to standards set in a policy resolution, the types of concerns raised in the Board's list of questions.

The Scope of the Board's Authority Over Defining Hardship

The Board has a broad range of discretion to define what constitutes a hardship. While this range probably should be used with care, always from the starting point that leases are generally prohibited, and not use the hardship as a means to avoid the restriction completely.

For example, where the CC&Rs specifically provide that a party that is permanently transferred out of the Portland Metro area must list their house, and can apply for hardship under certain specific criteria after a certain time, you must follow those criteria on that fact pattern and not deviate from the recorded CC&Rs. However, I believe where the situation was one of job loss or a severe illness that rendered the homeowner incapable of otherwise making payments without leasing and the homeowner is trying to sell the property, this would be a suitable basis for considering hardship relief.

In my opinion, the writers of the CC&Rs did not intend for houses to sit empty and go into foreclosure, and probably the writers did not envision the sort of economic conditions in the housing market we have seen since 2008. However, the writers, in my opinion, have given the Board enough flexibility in defining additional hardship situations to address temporary economic declines and mild recessions. Obviously, in the event of a full-blow depression like the 1930s, it would be advisable to rethink the impact of many covenants on owners' ability to pay assessments and make house payments and otherwise stay in their houses, and amendments may be warranted through action of the membership.

Responses to Some Specific Board Questions

- Documentation regarding illness: This is obviously a sensitive subject, but I would recommend the Board require that hardships for illnesses be tied to a financial burden or inability of the owner to maintain the property otherwise. For example, if a couple lives in a house, and only one spouse works and the nonworking spouse falls ill but this does not lead to a loss of job/income to the family or inability to reasonably maintain the property to the Community Wide Standard, arguable the illness, while a hardship generally, is not the type of hardship for which leasing rights should be granted. Alternatively, if the illness of a non-working spouse was documented to have caused the working spouse to have to go to ½ time and for the family to downsize, but they were unable to sell, this would be grounds for granting

a hardship. The Board has to have flexibility to exercise some fact-finding ability and weigh each case on its facts.

- Sales on contract: since these real estate agreements create a real obligation to deliver a deed to the land, are essentially a security interest in land held by the seller, and there is a risk of forfeiture of the land (like a foreclosure) in the event of default, these are and should be treated as any other sale. The Board could adopt a rule to require that the Board be given a copy of such contracts. Also, usually, unlike most residential leases or lease options, there will be some recording related to the agreement.
- Fines: A substantial fine for not applying for hardship *prior* to leasing is appropriate in my opinion given that it is difficult and expensive for the Board to do something about the tenancy after the tenant is occupying the property. The Board might consider including language in its policy resolution noting that this is the specific reason for the large fine for not seeking approval of a lease through the hardship process prior to leasing. The Board might also consider allowing the Board the option to impose "up to" $1,000 in fines depending on the facts and circumstances related to the failure to seek approval. The Board might also consider removing the "every 30 days" language, or changing it to "quarterly" if the Board feels the potential enforcement fine is too heavy.
- Preventing a move: The Board cannot prevent parties moving, but can and should enforce the covenants, rules and regulations. If a party elects to buy up and then wants to rent simply because of a bad investment decision and failure to sell the old property and is "straddled" – the Board could decide that is not a valid hardship without other factors.
- Time limit on hardship approval: There is no specific time limit on hardship approvals requiring the Board limit the authorization to no more than 1 year, other than that adopted by the Board's own resolution. The CC&Rs do not require you to make them expire after a year and it's possible to authorize the hardship for a longer period. However, one year is a reasonable period to revisit for compliance/changed circumstances, and currently the Declaration requires that the term of any lease be one year in duration.
- Continuous Listing: The language in the CC&Rs about continuous listing of the property, in my opinion, is reasonably read and interpreted as meaning that the applicant for a hardship lease approval must have attempted to market the property reasonably, but unsuccessfully for at least 90 days continuously, and for a continuous period up to the application for a hardship lease. I do not believe that this provision requires the counterproductive action of trying to continue to market the property for sale after the party has obtained a hardship lease approval and leased the property. I also note that this only appears to apply to those who are seeking a hardship due to a permanent relocation outside of the Portland Metro area and does not apply to all categories of potential hardship relief (see also footnote 1 below).
- Renting to Family Members: I note that one area that is expressly allowed as a "hardship" although it requires no establishment of a particular example of financial duress is the renting to "immediate" family members. The only proof required is that the applicant show a lease to someone in their immediate family, and, apparently, some unsuccessful efforts to sell the property, presumably to be judged by the Board as to satisfactory effort.[1]

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[1] I also wish to note that in the following sentence, the last sentence to subsection (c), which applies generally to all hardship requests, it states: *"Those Owners who have demonstrated that their inability to* ***lease*** *their Unit would result in undue hardship and have obtained the requisite approval of the Board may lease their Units for such duration as the Board reasonably determines is necessary to prevent undue hardship notwithstanding the provisions of subsection (b)."* (Bold/underline emphasis added). The use of the phrase "inability to lease" clearly should be understood as a typo in the document and as intended to be "inability to sell." This suggests also that all hardship applicants must have made some reasonable attempt to sell the property (whether or not the rigor required by the specific clause about relocating parties applies).

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Practical Suggestions

I recommend the Board consider doing the following things:

1. Be willing to consider continuing to remain flexible as to hardships. While I understand the desire of the Board for fairness and a level playing field, the hardship policy of the Board need not be fixed for all time, but could be responsive to the current economic situation. Thus, it could be revisited in 2 or 3-years' time if the housing market changes. The most important aspect is that the Board communicate with the community in advance the reasons for the tightening or loosening of hardship restrictions that the Board will consider. Moreover, the CCR's probably ought to be reviewed every 5-7 years in any case to assess whether they reflect the current realities in the community.
2. Consider adding to your hardship policy the specifically defined instances and restrictions for those hardships listed in the CC&Rs, in addition to the description currently in the policy.
3. Consider adding military mobilization, or other activation to duty outside the Portland Metropolitan area for a period in excess of 59 days as an express basis of hardship.

Conclusion

I believe the Board has sufficient flexibility to address most situations with its current hardship policy, when taken with consideration of the above suggestions. However, if the housing market or general economy worsens, the Board may need to consider addressing these issues through amendments to the governing documents by vote of the membership. The various categories of hardship are sufficiently broad to meet most situations, and the CC&Rs and policy resolution leave enough room for the odd case to be considered for eligibility.

If you have a specific case that comes up that you would like assistance in considering, I am happy to do so and have done so for some other associations that have had to make hard distinctions between one case of allowed hardship and another where the Board felt it should be denied.

I am also happy to assist the Board in revisions to the hardship policy, if the Board so chooses, or in consideration of amendments to the Declaration to achieve the goals of the community. I am also happy to attend a Board meeting if further face-to-face discussion of these matters is more helpful and efficient for the Board.

As always, I appreciate your time. If you have any questions, please feel free to call me at 503-267-9863 or e-mail me at ejt@erictenbrooklaw.com.

Very truly yours,

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