Bond Case Briefs

Municipal Finance Law Since 1971

A Municipal Finance Tool to Avert Another Deadly Condo Collapse.

Local governments could turn to special assessment districts to cost-effectively assure safety improvements, bypassing occupants' foot-dragging and dysfunctional homeowners' associations.

Experts have yet to determine the precise causes of the June 24 collapse of a Surfside, Fla., condominium tower in which 98 residents died. But policymakers don't need to wait for engineering reports to tell us what is painfully obvious: Condo ownership associations and their volunteer boards are ill-equipped to tackle serious safety deficiencies in high-rise buildings. Of the 160,000 condominium buildings in the U.S., tens of thousands are precariously underfunded.

The public finance profession has long understood the "tragedy of the commons," in which everybody enjoys the benefits of community property but their self-interested collective neglect leads to its demise. In the Surfside property, the homeowners' association had been delivered a clear warning that structural defects were mounting and collective remedial action was required. Yet the building's HOA board became so frustrated with securing unit owners' consent that many of its members resigned, and costs kept mounting. A problem that might have been solved a few years ago expanded — "exponentially," in the words of an inspector — to the point of no return. The Champlain Towers South disaster goes down as one of American history's most horrific and insightful examples of the tragedy of the commons.

Finger-pointing and blame-laying will go on for months, and undoubtedly there will be new laws to require more frequent safety inspections. But where local governments also need to focus their policy reforms is on the remediation process itself, to provide a cost-effective mandatory protocol for timely funding of structural repairs in isolated cases when private ownership fails.

Anybody who's lived in a residential community with HOA fees knows how much carping goes on over dues assessments to advance-fund repairs and replacements of common facilities. "Why should we pay now for benefits that will be enjoyed by future owners?" is the all-too-familiar complaint of the tightwads and procrastinators. Even if an HOA is able to borrow money for necessary repairs and bill the owners through installments, there will be defaults and delinquencies. In the Champlain Towers case, the cost per unit for remediation was estimated to be six figures, a staggering cost for some occupants. Would you want to serve on an HOA board facing such opposition and likely litigation from all ends?

A SAD Opportunity

Fortunately, there is a legal and financial tool that can be adapted to solve the problem of the tragedy of the condominium commons: special assessment districts. In California, they are known as Mello-Roos districts, and most states have laws on the books that authorize municipalities to levy a special charge on properties for a wide variety of public improvements that benefit the owners within a designated district, or in some cases even a single building. The bill can be per owner or (in

some states) ad valorem based on property values. The municipality that establishes such SADs, as they are known, can take out bank loans or sell bonds, often at lower tax-exempt interest rates, to finance the improvements that are secured by the liens on the properties. In the case of condos, the special financing bonds would have to be secured by a senior tax lien on the underlying land, and in some states, new laws may be needed for single-building districts.

Few condo boards can ever hope to attain long-term financing at such low costs. Most importantly, the SAD tax collections are liens on property and payable by installments so that owners don't have to cough up the full cost of repairs immediately. When a unit is sold, some states and escrow companies require that the entire assessment be paid off to remove the lien, and the new owner essentially absorbs that cost in the mortgage. But however they are structured, SADs can accomplish what HOAs sometimes cannot.

Of course there are drawbacks. For municipal finance departments and property tax collectors, administering these special districts poses a thankless task. Most assessment districts are relatively small and clutter the books, so many localities charge modest administrative fees to compensate for the staff work they require. Unless consolidated into an annual debt issue, the litter of small individual SAD debt issues can become a fiscal management nuisance — but nothing in comparison with the resources demanded of a municipality that suffers a building collapse. It's important to retain perspective here and put safety before bureaucracy.

When Lives Are at Risk

This brings us to the implementation process, which will require thoughtful policy design. In some localities, existing laws and policies may require tweaking. One example is how timely intervention could be triggered proactively by the municipal governing body, either upon recommendation of the building inspection department or the HOA board. Usually such municipal actions require a public hearing, but the authority ultimately resides with the municipal governing body. Typically the project work is performed by the local government by contract, which raises questions about eminent domain, indemnification, property access and possibly private activity bond tax rules that may require updated laws and local policies.

Those laws and policies should establish criteria for declaring a demonstrable and documented public safety interest in mandatory improvements to a privately owned building. Doing this without stigmatizing the property is an issue to address. By state law, an intervening local government should be indemnified, given the legal jeopardy and certified structural risks. Statutory or written criteria could provide a checklist for local officials to follow before instigating public intervention.

Perhaps every new high-rise building's land-use permit and periodic recertification should require creation of a dormant special assessment district that can be activated and invoked immediately upon certification of major structural remediation requirements. If time allows and depending on the severity of defects and risks, the HOA could be given a short grace period to undertake repairs on its own. But the community interest should not be hamstrung by time-wasting protocols or stalling tactics, especially when lives are at risk. In some cases, precautionary evacuations may be necessary, with temporary housing allowances added to an owner's amortized project assessment.

This financial tool is no panacea, and should be used only in rare cases. But its availability will provide a safety net. Municipal attorneys, along with policy and professional organizations, can guide the way for precautionary enabling legislation and local risk management policies.

governing.com

August 3, 2021 • Girard Miller