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Purchasing Investment Properties in Community Associations: Tips and Traps



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As we know, in these trying economic times, many homeowners are unable to make their monthly mortgage payments, and are losing their homes to foreclosure. The foreclosure crisis has no doubt wreaked havoc on many households throughout the area.

The foreclosure crisis has also hit community associations particularly hard. In some community associations, as many as half of the homes are in some stage of foreclosure. The same crisis, however, is creating opportunities for those interested in acquiring properties for investment purposes. Townhomes and condominium homes can be attractive additions to an investor's real estate

portfolio. However, every opportunity carries some risk. While all prospective purchasers need to review an association's governing documents and financials, investors need to undertake certain additional levels of due diligence when considering a purchase of a townhome or condominium for investment purposes. A failure to do so can have catastrophic results for an investor.

Can the property be leased?

A threshold question for an investor is whether homes in a community association may be leased, and, if so, what leasing restrictions the association may have adopted. Investors should appreciate the difference between regulation of leasing and restriction of leasing. Restrictions on leasing must be stated in the association's declaration, and address whether or not an owner is free to lease his or her home. Regulations regarding leasing may be stated in the declaration or in the rules, and address the policies and procedures an owner must follow if he or she wishes to lease her home.

If an association restricts leasing, an investor may still be able to lease a home purchased in the community. Few communities prohibit leasing altogether. Many communities restrict the number of homes in the community that may be leased at any given time. If the number of homes leased in the community is below the cap set forth in the declaration, an investor would be entitled to purchase the home with the intent to lease that unit, provided the investor abides by any leasing regulations imposed by the association (i.e., performing background checks, providing contact information, paying administrative fees related to processing documents related to the leasing, etc.)

Even if an association does not currently restrict leasing, an investor would be well-served to specifically inquire about any discussions the association may have had about restricting leasing or any efforts undertaken to restrict leasing. Even if leasing is currently permitted, an association could later seek to restrict leasing by amending its declaration. Contrary to some investors' belief, if an association follows proper procedure to amend its declaration to restrict leasing, such restrictions are enforceable against current owners as readily as against new owners. Unless the amendment specifically "grandfathers in" existing owners or existing owners of leased homes, such owners are not entitled to claim an exemption from the restrictions. An association that has discussed adopting leasing restrictions in the past may consider adopting such restrictions again in the future. Purchasing a home in a community eager to adopt leasing restrictions may leave an investor owning an investment property that cannot be used for its intended purpose, which may bring the problem full circle: the investor is unable to lease the property, is then unable to make mortgage payments, and then loses the property in foreclosure.

What are the rules regarding leasing?

Assuming leasing is permitted (or that the cap on leased units has not been reached), investors must be cognizant of regulations an association may impose on leasing. Some associations require use of a specific lease form. Some require use of a particular addendum to the lease that outlines rights and obligations involving the association, including the obligation of tenants to abide by all of the covenants and rules governing the association. In many associations, tenants who contact the association's management agent or Board for non-emergency issues will trigger a violation—and fine—which must be addressed by the

owner. It is important, therefore, that the investor is familiar with the rules—and that the investor ensures that the tenant is also familiar with those same rules.

How can I convince the Board I'll be a "good landlord?"

Associations sometimes errantly place all the problems of the association on the doorstep of its rental homes. In fact, troublesome homeowners can cause even greater problems for an association than a troublesome tenant. Tenants who create problems for an association often also create problems for the landlord. Tenants who violate the terms of the association's governing documents cause the landlord to incur fines, which reduces the profitability of that investment property. Troublesome tenants also cause non-financial tension between the landlord and the association—and can cause the landlord to incur the wrath of the association. So how can an investor be a "good landlord?"

Most basically, proper screening of tenants is critical. Tenants who have caused problems in the past are more likely to cause problems again. Tenants who ignore a landlord's requirements are likely to ignore an association's requirements. A landlord who addresses an association's concerns swiftly and maintains open lines of communication with the association will likely have a strong and positive relationship with the association. A landlord who becomes involved and stays involved with the association (serving on committees, serving on the Board of Directors, responding to requests promptly, etc.) will be viewed by other owners as a neighbor, not simply an "absentee landlord" (with all the negative connotations that accompany that label). Staying involved will also allow the investor to stay informed and connected to the community, allowing the investor to take action or defend investors against unwarranted complaints assumed to be the result of having investment property in the community.

Purchasing investment property in community associations can be financially rewarding. Before choosing to purchase investment property in a community association, however, it is imperative that investors carefully review the association's governing documents and that they understand the rights and responsibilities of all owners in the community—both those who live in the community and those who live off site. The attorneys at Hellmuth & Johnson can assist investors in reviewing those documents and explaining their terms in a manner that is both professional and comprehensive. For further information, contact Nancy Polomis at npolomis@hljlawfirm.com or 952-746-2105.

H&J Announcements

H&J Adds New Attorneys ...

Russell "Mick" Spence, Jr. has joined the firm as a partner in the Business & Corporate practice group. He litigates and counsels entertainment, intellectual property and business clients in a wide variety of legal matters. Combining his passions for creativity, commerce, advocacy and success, Mick has established a reputation as the go-to attorney for both creative talents and entrepreneurial businesses. We look forward to his complimentary practice strengthening the business services we provide, while expanding our growth to benefit both existing and new clients.

Joshua R. Ward has also joined the firm as an associate and is a member of the IT & eCommerce and Business & Corporate practice groups. He obtained his JD from William Mitchell College of Law where he served on the Editorial Boards of the *William Mitchell Law Review* and *Cybaris: An Intellectual Property Law Review*.

This newsletter provides general information on legal matters, and should not be relied upon as legal advice. A qualified attorney must analyze the relevant facts and apply the applicable law to provide specific legal advice. If you require legal advice or want additional information regarding the services we offer, please contact David Hellmuth at 952-941-4005 or dhellmuth@hljlawfirm.com



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