

# “New DCA Rules Regarding Benefit Derived and Reserves,” Community Trends Magazine

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For decades associations and developers in transition have been plagued by ill-defined concepts embodied in the rules of the New Jersey Department of Community Affairs (DCA) governing the developer’s obligation to pay common expenses for units under development and individually owned “in proportion with the benefit derived by the unit from items included in the budget.” Similarly, the rules have required that developer-prepared budgets include “adequate reserves for repair and replacement of the common elements and facilities.” There are also allied issues, such as what use may a developer-controlled board make of the working capital contribution made by each unit owner? The ambiguity inherent in phrases like “benefit derived” and “adequate reserves” has led to endless debates, and sometimes litigation, over whether the developer paid its share of the common expenses and created a budget with reasonable contributions to the association’s reserves.

## Addressing the Problem

Starting two years ago representatives of the CAI Legislative Action Committee (LAC), the CAI-NJ chapter board and the New Jersey Builders Association agreed to commence meetings in an effort to draft new rules acceptable to both groups that would resolve the thorny issues inherent in the existing rules. A cooperative spirit led to the drafting of proposed rules that were presented to the DCA. After several meetings with DCA’s representatives, agreement was reached concerning the joint proposal made. The drafting of new rules is a multi-step process at the state level and the DCA had warned that it could not predict how the rules would appear after going through the various parties who would review and comment on the proposed rules. After a year in that process the proposed rules were published in June of this year and to the DCA’s credit they resulted in rules that were virtually identical to those agreed upon. The

public comment period on the new rules ended on August 14, 2020, and after its review of the public comments the DCA will publish final rules. The parties are optimistic, given the support of the two most impacted groups, that the number of public comments will be few, and the final rules will be published within the next six months.

## **Proposed Rules**

Given that, it is expected that the final rules will contain the following:

- The concept of the developer making payments based on the benefit derived by units under construction and completed will no longer exist.
- Instead, the developer will be required to pay 100 percent of the monthly assessments for all units that a developer has registered with DCA in a particular phase or for a single project, no matter what state of construction or completion the units that have been registered are in.
- When a deficit occurs based on a developer-prepared budget, the developer must pay for the deficit, unless it occurred as a result of unforeseen or unanticipated expenses (such as unusually high snow removal costs). In the event of extraordinary expenses both the developer and unit owners pay their proportionate shares. The terms “unforeseen” and “unanticipated” are defined in the proposed rule.
- Budgets are to be based on the actual, anticipated association expenses for the number of units that the developer will register and sell in a given fiscal year. The budget contained in the public offering statement will no longer be based on “full occupancy,” which frequently does not comport with the actual expenses expected prior to full build-out
- Working capital collected from the initial purchasers can only be used for certain one-time startup expenses such as association owned office equipment or initial utility deposits. In addition, the working capital can be used to offset unforeseen or unanticipated expenses. Otherwise, the working capital must be available to the association at the time of turnover of control of the board to the unit owners. The use of working capital must be documented in the minutes of the developer-controlled board.
- Reserves are to include all capital improvements in a community that have a life of less than 30 years — other than roofs, which must be reserved for from the inception even if their expected life is more than 30 years. The developer’s budgeted reserve amount must be based on a study prepared by a licensed engineer or architect.
- As new phases are added the developer must update the reserve amounts and the reserve study. Where field changes occur in the development of a project, the reserves budgeted for must be updated to reflect the “as built” project, which sometimes materially differs from the pre-construction study prepared by the developer’s architect or engineer based on the proposed plans.
- The developer-controlled board may not use reserve funds for repair or replacement of capital improvements unless 90 percent of the improvement’s life is exhausted.

- Developers may create a reserve budget with threshold funding as opposed to full funding. Virtually all associations controlled by unit owners use a form of threshold funding of their reserve accounts and it is expected that many developers will adopt similar approaches for developer-prepared budgets.

The proposed rules go into more detail than this brief over-view can describe. In addition, these new rules only apply to developer-prepared budgets for associations. Once the owners gain control of the board these requirements will no longer apply, other than the developer's obligation to contribute to the common expenses while developing and selling the final 25 percent of the units.

## **Conclusion**

Assuming the final rules match the proposed rules in all material respects – which is expected – it is anticipated that these rules will make clear what developers, unit owners and associations are each financially responsible for during the period of the developer's control of the association. As a result, at least with respect to these transition issues, there should be less opportunity for disagreement and litigation.