

HOA University
October 3, 2009

Common Area Maintenance Versus Capital Improvements

I. Why Does it Matter if it's a "Capital Improvement"?

A. It only matters for our discussion today if your governing documents specifically require a vote and approval of the homeowners before a Board can initiate and pay for capital improvements. It matters then because it can be very difficult and impractical to get owners to approve every little repair or reconstruction project.

B. Do your governing documents say something like this:

"There shall be no capital improvements of the Common Areas and Facilities requiring an expenditure in excess of \$5,000.00 without the prior approval of Owners holding 67% of the total votes."

If so, even the most basic and small repairs could require owner approval.

II. What is a Capital Improvement?

A. There are many definitions of "capital improvement." The IRS defines certain items, such as painting, as maintenance or operations and it does not consider these types of expenses as capital expenditures. Whether certain contributions to capital are recognized by the IRS as tax deductible is not discussed here. Reference to IRS definitions is made merely to highlight the confusion and different definitions of "capital improvement" depending on the context.

B. The only definition that matters in our context today is the one provided by the Utah Supreme Court. The Supreme Court stated "**Capital improvements are betterments of a long lasting nature which add to the capital value of the property.**" The Supreme Court reviewed a case where repairs to a swimming pool were made. The Court said, "**here, the repairs made to the swimming pool and clubhouse qualify as capital improvements because they replaced deteriorating parts of the structures, with the effect of increasing the worth of the facilities. As they now stand, the facilities are rejuvenated and improved.**" (*Three Fountains Owners Association v. Shar Leigh* Lexis 133, Utah App. 1998).

As you can see, the definition of "capital improvement" is very broad and all encompassing. Just about every repair or reconstruction, except day to day maintenance, is a capital improvement.

C. The problem is not so much whether the board can install a new improvement where no improvement existed before, such as a hot tub, or a security gate, without owner approval. Or even whether the Board can materially change or “upgrade” existing improvements, like replacing asphalt shingles with ceramic tile, or wood fencing with vinyl fencing. The issue that can be very problematic for associations is whether the board is empowered to carry out periodic repair and replacement of common area elements (replace asphalt shingles with asphalt shingles, for instance).

D. Consider the liability that the association is exposed to when they can’t carry out necessary repairs to the common area. What if a structure or roof fails and injures someone because the vote to repair the structure didn’t pass or because a quorum wasn’t obtained so the vote never occurred?

III. The Distinction Between Collecting the Money Versus Spending the Money.

A. Your documents very likely make a distinction between levying a special assessment and making capital improvements. These are two totally different things and you may need homeowner approval to do one but not the other or to do either one. Don’t be confused into thinking that they are the same thing or that they will always go together. Levying a special assessment has to do with collecting the money from owners. Making capital improvements has to do with spending the money after it is collected.

IV. Amend Your Governing Documents.

A. If your governing documents have this limiting language, you should consider trying to amend it away as soon as possible. However, simply deleting the language will not likely go over well with the homeowners because they usually want to retain all the control they can without realizing the crippling effect it can have on their association. Homeowners simply do not realize that they may be sitting in their leaky condo unit for months, rain leaking all over their furniture, while the association struggles to get a quorum to attend a special meeting to approve a re-roofing expenditure.

B. Magic Wording. If homeowners stubbornly refuse to delete such a provision from your documents, then alternatively the following phrase should be inserted in the provision, “**other than for purposes of replacing portions of the Common Area.**” So, the provision in Section II above would then read:

“There shall be no capital improvements of the Common Areas and Facilities (**other than for purposes of replacing portions of the Common Area**) requiring an expenditure in excess of \$5,000.00 without the prior approval of Owners holding 67% of the total votes.”

Alternatively, raising the dollar amount threshold requiring owner approval would be helpful if all else fails.

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