CHICAGO TITLE INSURANCE COMPANY

TOPIC: Restrictive Covenants – Impact of Armstrong

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The North Carolina Supreme Court in Armstrong, et al., vs. Ledges Homeowners Association, et al., 360 N.C. 547, 633 S.E.2d 78 (2006), held that a homeowner's association may amend a declaration only if the amendment is reasonable despite express language in the declaration allowing the homeowners' association to amend the same by majority vote without restriction. In Armstrong, subdivision property owners brought an action against their homeowners' association questioning the validity and enforceability of an amendment to the subdivision declaration substantially broadening the ability of the association to assess the homeowners.

The subdivision was developed in 1988 pursuant to a plat recorded in the Henderson County Registry. The plat showed 49 lots set out along two public roads with no common areas or amenities. Prior to selling any lots, the developer of the subdivision recorded a declaration, among other things, restricting the lots to single-family residential use and establishing setbacks, side building lines, minimum square footage, and architectural controls. The declaration also provided for the establishment of a homeowners' association to (together with subdivision owners acting individually or as a group) "administer and enforce the provisions of this Declaration of Restrictive Covenants as the same now exists or may hereafter from time to time be amended." The initial declaration did not contain any provision for the collection of dues or assessments. Id. at 549.

After recording the declaration and plat, the developer erected a lighted sign on private property along the entry road into the development. In contemplation of an indefinite utility bill for lighting the sign, the developer began to include the following language in his new conveyances:

> The grantor herein contemplates the establishment of a non-profit corporation to be known as The Ledges of Hidden Hills Homeowners Association, and by acceptance of this deed the grantees agree to become and shall automatically so become members of said Homeowners Association when so formed by said grantor; and said grantees agree to abide by the corporate charter, bylaws, and rules and regulations of said Homeowners Association and agree to pay pro rata charges and assessments which may be levied by said Homeowners Association when so formed. Until the above contemplated Homeowners Association is formed or in the event the same is not formed, the grantor reserves the right to assess the above-described lot and the owners thereof an equal pro rata share of the common expense for electrical street lights and electrical subdivision

> entrance sign lights and any other common utility expense for various lots within the Subdivision.

Id. at 550.

Following its organization, the homeowners' association began assessing lot owners for the bills incurred for lighting the entrance sign, and then later, for mowing expenses on individual private lots, snow removal from subdivision roads, and operating and legal expenses. Id. at 551. According to testimony, the electrical bill for the entrance sign should have been $7.20 annually for each lot, but lot owners were being billed annual assessments of approximately $80 to $100 per year. Following the receipt of complaints of subdivision lot owners and the filing of their initial lawsuit regarding the assessments, a majority of the homeowners' association amended the declaration to include provisions substantially different from those in the original declaration, most notably that fees are to be assessed lot owners "for common expenses" and "shall be used for the general purposes of promoting the safety, welfare, recreation, health, common benefit, and enjoyment of the residents of Lots in the Ledges as may be more specifically authorized from time to time by the Board." Id. at 553.

The lot owners amended their lawsuit to challenge the amendments to the declaration. The trial court dismissed the lot owners' claims and in so doing found the amendments to the declaration to be valid and enforceable. The North Carolina Court of Appeals affirmed the decision of the trial court.

The petitioners appealed to the North Carolina Supreme Court on the basis that the scope of the amendment to the declaration exceeded the authority granted to the homeowners' association in the original declaration. The Supreme Court in rendering its opinion went a great distance to emphasize that in communities not subject to the North Carolina Planned Community Act "the powers of a homeowners' association are contractual and are limited to those powers granted to it by the declaration." Id. at 551. The Supreme Court embraced the need for specific provisions authorizing amendments to declarations intended to govern communities over long periods of time, but the Supreme Court emphasized the need for balance between the desires of the majority of homeowners and the original bargain of those in dissent.

> Amendment provisions are enforceable; however, such provisions give rise to a serious question about the permissible scope of amendment, which results from a conflict between the legitimate desire of a homeowners' association to respond to new and unanticipated circumstances and the need to protect minority or dissenting homeowners by preserving the original nature of their bargain. In the same way that the powers of a homeowners' association are limited to those powers granted to it by the original declaration, an amendment should not exceed the purpose of the original declaration.

Id. at 558.

In this case, the Supreme Court established a standard for ensuring that balance between the desires of the majority and the integrity of the original bargain negotiated by the subdivision property owner:

> We hold that a provision authorizing a homeowners' association to amend a declaration of covenants does not permit amendments of unlimited scope; rather, every amendment must be reasonable in light of the contracting parties' original intent.

Id. at 559.

The Supreme Court also set forth a means for testing the reasonableness of the amendment:

> The Court may ascertain reasonableness from the language of the original declaration of covenants, deeds, and plats, together with other objective circumstances surrounding the parties bargain, including the nature and character of the community. For example, it may be relevant that a particular geographic area is known for its resort, retirement, or seasonal "snowbird" population. Thus, it may not be reasonable to retroactively prohibit rentals in a mountain community during ski season or in a beach community during the summer. Similarly, it may not be reasonable to continually raise assessments in a retirement community where residents live primarily on a fixed income.

Id. at 558.

In Armstrong, the property owners purchased lots in a small residential neighborhood with public roads, no common areas, and no amenities. Neither the original declaration nor the plat showed any source of common expense, and evidence in the case showed that was the expectation of many property owners. Despite the affirmative language in the deeds regarding utility bills incurred for lighting the entry sign, such a provision was hardly enough to show that the property owners at that point intended to confer unlimited powers of assessment to the homeowners' association. With this in mind, the Supreme Court concluded that the amendment to the declaration allowing for broad assessments was unreasonable because it was contrary to the original intent of the contracting parties. According to the Supreme Court:

> Here, petitioners purchased their lots without notice that they would be subjected to additional restrictions on use of the lots and responsible for additional affirmative monetary obligations imposed by a homeowners' association. This Court will not permit the Association to use the Declaration's amendment provision as a vehicle for imposing a new and different set of covenants, thereby substituting a new obligation for the original bargain of the covenanting parties.

Id. at 561.

The point to be taken from Armstrong is that North Carolina law requires an amendment to a declaration of restrictive covenants to be "reasonable in light of the contracting parties' original intent." Id. at 559. An amendment that has been correctly enacted procedurally will not survive

scrutiny if it has the effect of changing the original contractual terms entered into by the property owner. In such event, the courts may step in to preserve the benefit of the property owner's bargain.

The Supreme Court does not expressly limit its decision to communities that are not governed by the North Carolina Planned Community Act. The Supreme Court does, however, mention several times in the case that the community at issue is not so governed, and therefore, the powers of the homeowner's association are strictly contractual, and not also statutory as would be the case if the community were a "planned community" as defined in Chapter 47F of the North Carolina General Statutes or a condominium subject to Chapter 47C. The application of this decision to communities governed by Chapters 47C or 47F is not entirely clear.

Sections 47C-2-117(a) and 47F-2-117(a) both generally provide that the declaration may be amended only by the vote of at least 67% of the votes of the association unless a higher threshold is required within the declaration itself. Neither Chapter 47C or 47F expressly requires the amendment to be reasonable. However, Section 47C-2-117(d) also provides:

> Except to the extent expressly permitted or required by other provisions of this Chapter, no amendment may create or increase special declarant rights, increase the number of units, or change the boundaries of any unit, the allocated interest of a unit, or the uses to which any unit is restricted, in the absence of unanimous consent of the unit owners.

(Note that Sections 47C-2-117 and 47F-2-117 are almost identical except that subsection (d) of Section 47F-2-117 has been reserved rather than containing a provision similar to Section 47C-2-117(d)). An argument could seemingly be made that the "reasonableness" threshold established in Armstrong is not applicable to amendments to a condominium declaration because the General Assembly in Section 47C-2-117(d) has established by statute a protection against majority overreaching and the only caveat to the general 67% of votes threshold. Of course, at this point, the issue is still up for debate.

In the event that the reasonableness standard does apply to planned communities and condominiums, study of the provisions within Chapter 47F and Chapter 47C would be required to determine the intent and expectations of the buyer. Moreover, in those cases where the buyer's intent and expectations are not entirely clear, because planned communities and condominiums are also creatures of statute, it could be the case that matters of public policy (such as clarity and efficiency in administration which could be argued with regard to Section 47C-2-117(d)) override such intent and expectations.