The Do's And Don'ts of HOA Rental Restrictions

By Christopher R. Moore, Esq.

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Overview

Since prior to independence, the American legal system has aimed to protect the rights to "life, liberty, and property." Implicit in the right to property is the idea that every owner of real estate has the privilege of using the land as he or she sees fit (as long as no illegal activity occurs, of course).

Yet, although land-use restrictions are viewed skeptically in American courtrooms, such restrictions exist and are, in fact, quite common. This apparent contradiction arises from the law's recognition that, in certain scenarios, a reasonable restriction on a landowner's property rights can benefit the community as a whole – as long as the restriction is designed to serve a legitimate purpose.

Can an HOA restrict a member's right to rent his or her property?

Rental restrictions undeniably limit the free-use of property. Nonetheless, courts throughout the country have consistently upheld such restrictions when rationally calculated to promote the development's greater good. Even blanket rental prohibitions have been reluctantly upheld in some states, as long as the association has a legitimate purpose for the restriction. *See Four Brothers Homes at Heartland Condominium II, et. al., v. Gerbino*, 691 N.Y.S.2d 114 (1999).

"Legitimate purposes" justifying rental restrictions typically involve maintenance of property values and promotion of community standards. More renters within a

development can result in higher liability insurance rates and lower property values, so a cap on rental properties might protect members financially. Likewise, rental restrictions can increase the number of residents with a vested interest in the development's long-term success, thereby promoting neighborhood stability and a sense of community. Because renters tend to be more likely to violate association rules and less likely to obey upkeep standards, promoting compliance with covenants might also be a legitimate purpose for rental restrictions.

Along with serving a legitimate purpose, to be enforceable a rental restriction must be a "reasonable" means of accomplishing the stated goal. The inquiry is fact specific, but, in general, a restriction is reasonable if it is rationally related to the protection of property and promotes the purposes for which the association was created. *Laguna Royale Owners Assn. v. Darger,* 119 Cal.App.3d 670(1981). If this standard is met, and the restriction is enforced in a fair, nondiscriminatory manner, it will likely be enforced. *Id.*

What forms of rental restrictions can an association adopt?

Rental restrictions come in several forms, two of the most popular of which are caps and lease restrictions. Rental caps limit the total percentage of homes (commonly 20%) that can be rented in a development at any given time. The board usually approves rentals on a first-come, first-served basis and might have to keep a waiting list if the cap is reached. An alternative approach, designed to discourage purchases made solely for investment, requires new owners to reside in the home for at least one year before renting.

Lease restrictions set forth certain provisions which must be included within any lease agreement offered by a lot owner. A common lease restriction establishes a minimum lease period (e.g., 30 days), so as to avoid vacation rentals and high community turn-over. An association's covenants might also make a renter's compliance with community standards a mandatory term of every lease, thereby granting the landlord authority to evict a non-complying tenant.

Can an association screen prospective tenants?

Some associations reserve the right to "screen" prospective tenants in hopes of avoiding renters who might be detrimental to the community. This policy typically has members submit a potential tenant's rental application to the board for approval before a lease can be signed.

Before implementing a policy along these lines, the board should ensure that it complies with state law. Arizona law, for instance, expressly forbids associations from compelling members to submit tenant applications for board approval. A.R.S. §33-1806.01(E)(1).

An Arizona association can only ask for a prospective tenant's name and contact information and the lease's time period. A.R.S. 33-1806.01(C). By contrast, California mandates that owners provide an applicant's name and contact information to the board before leasing the property. Cal. Civ. Code §4740(d).

Tenant approval provisions are a tempting option for associations because they allow the board to weed out tenants who might not harmonize with the community. However, tenant-screening should be exercised with caution. The federal Fair Housing Act forbids discrimination in housing based upon race, color, religion, sex, familial status, national origin, or disability. 42 U.S.C. §3604(a).

Even if a screening policy is not intended to discriminate based upon any of these factors, if the policy results in a "disparate impact" on a protected class, it may violate the FHA. *Texas Dept. of Housing and Community Affairs v. Inclusive Communities Project, Inc.*, 135 S.Ct. 2507 (2015).

As such, any community wishing to screen prospective tenants should take great care that the screening process is both neutral on its face and does not disproportionally impact any protected class.

Do associations have to disclose rental restrictions?

For the most part, rental restrictions must be adopted in an association's recorded declaration. Arizona law explicitly protects members' right to free-use unless a rental restriction is included in the declarations. A.R.S. §33-1260.01(A).

The legal theory is that, upon purchasing a property in the community, a new homeowner is deemed to have accepted the covenants in the declaration, which is a public record. Most transfer deeds also clearly say that the property is conveyed subject to any covenants and restrictions. Consequently, any new owners are deemed to have "constructive notice" of all covenants, including rental restrictions.

Of course, it's still a good idea to provide *actual* notice of covenants and restrictions to a purchaser, rather than relying on constructive notice. A policy of providing written notice at the time of purchase avoids a scenario in which an owner later claims ignorance of the restriction. California solves this problem by giving purchasers the right to receive a statement of any rental restrictions before a sale contract can be executed or title transferred. Cal. Civ. Code §4525(a)(9).

Complications can arise when a member does not receive notice of rental restrictions (actual or constructive) at the time of purchase because the restrictions were implemented afterwards. Courts are reluctant to enforce restrictions adopted after purchase because the purchaser did not reasonably anticipate being bound by the restriction when accepting the deed. After all, the owner might have decided against buying the property had it been subject to rental restrictions at the time.

Contractual and Statutory Protections

Contractual protections commonly known as "Grandfather" clauses are designed to minimize potential legal challenges when new restrictions are adopted. The clause might allow any member renting a home as of the effective date to continue renting as long as he or she holds title to the property, with the exemption expiring upon transfer. Alternatively, the clause might permit existing leases to remain in place but not allow any new tenants. However, the latter approach still runs the risk of an owner contesting the restriction as an infringement of a vested right to rent the property.

The contractual exemption addresses the possible unfairness involved in enforcing a rental restriction against a member who purchased a home before the restriction took effect. A member who is protected by this clause typically receives an individual, non-transferable exemption from enforcement, allowing him or her to continue enjoying a vested property right.

Many states address this level of protection by statute. In California, a property-owner is completely exempt from a rental restriction if he or she owned the property prior to enactment of the restriction and does not consent to it. Cal. Civ. Code §4740(a), (b). And, in Florida, a rental restriction is only effective against an owner if the restriction was in place at the time of purchase or the owner voted for the amendment. Fla. Stat. §718.110(13). Similarly, in Arizona, rental restrictions are not effective against pre-existing owners unless approved by a unanimous member vote. A.R.S. §33-1227.

How does an association enforce rental restrictions?

Enforcing rental restrictions can be tricky. Because a tenant is not a member of the association – and therefore not subject to the board's enforcement authority – a board cannot "evict" the tenant of a noncompliant member. Instead, the board must direct all enforcement efforts at the owner him or herself. The board can impose fines or other disciplinary action authorized by the community's governing documents. Or, if administrative remedies are insufficient, the board can file a lawsuit against the lot owner and ask the court for an order enjoining further leasing of the property.

With significant economic interests at stake, it is not uncommon for owners to contest lawsuits enforcing rental restrictions. However, while American courts give considerable deference to property rights, reasonable rental restrictions validly adopted for a legitimate purpose have consistently been upheld.

Given the complex nature of the law relating to rental restrictions, boards compelled to take legal action against noncompliant members - and members concerned about wrongful enforcement - should consult with experienced counsel prior to taking legal action.