Extinguished dues or not?
HEPOA's covenanted membership obligations and processes for dues extinguishments
D. Esarey, August 2022

Following 2021 and 2022 changes in President, Treasurer, and Assistant Treasurer offices, the files and records of HEPOA were transferred and re-organized. All records, from the Association's 2008 formation to the present, were reviewed. All financial records were made electronic. One major concern requiring transparency came to the Board of Directors' attention.

HOA membership and dues

Membership and payment of annual dues for our HOA corporation (HEPOA) is covenanted by purchase of one or more lots in the development. North Carolina courts have repeatedly affirmed the obligation referred to in Article 1 of our Covenants (aka Declaration). Lot owners must belong to their HOA corporation and pay annual assessments as part of a continuing covenant that runs with purchase of each lot. Initial annual dues and terms of membership were set in the original (1999) Restrictive Covenants/Declaration as being on a per/lot basis for each of the original 56 lots connected to the Heritage Estates road and private drive system.

Covenanted conditions for combining memberships and changing lot boundaries

Heritage Estates' original developer (Juanita Gesling, first President of Heritage Estates, Inc.) installed a series of steps in the original 1999 covenants by which multiple lots could be "*combined and one residence… constructed on the combined tract*" after which the combined tract would "*thereafter be considered as one tract*" for the purpose of annual assessments. The Developer also reserved to herself the power to change "*the property line to any unsold lot*" as well as stipulating that "*no lot shall be further subdivided*." **Taken as a whole, these powers and restrictions show that the Developer intended that changing the boundaries of any lot after its initial sale was not allowed. Likewise, the Developers' intent in creating an option to make these alterations to deeds, membership, and dues structures was to incentivize the initial sale of the development's lots.**

These same powers passed to Developers James and Eloise Stewart upon their purchase of Heritage Estates, Inc. and its remaining unsold lots in 2004.

Developer combinations, dues extinguishments, and boundary changes

In practice, the "combinations" as described in the Covenants/Declaration were performed by the Developer by way of linkages inserted into the deeds of the lots in question. The powers to do so were invoked three times by the second Developer (Stewarts). In 2005 a buyer purchased both Lots 5 and 6. In that sale, the Developer set the stage to combine the two lot memberships into a single membership by way of the terms in their initial deeds and covenanted that they could not be sold apart from each other. Also included in the deed was the condition "…*providing that a home was subsequently constructed on the conjoined lots."* This meant that if the home was not subsequently built, the dues extinguishment of one of the dues paying lots (i.e., a membership) would not be allowed.

But the home was built and then the dues of Lots 5 and 6 were treated as a single tract as related to annual dues. Lot 5 and 6 boundaries were not changed or erased in the county's parcel and tax records.

In another 2005 instance, the Developer changed an unsold lot boundary, equally splitting Lot 34, and entering into the initial deed for each half a permanent covenant that the respective half lots must henceforth be sold with the adjoining lots (Lots 33 and 35). In this case, the initial deeds for the halves of Lot 34 cited his right to do so as "*developer and majority owner specifically excludes this transaction from restriction number four (#4) and invokes its right under restriction number two (#2) to change the property line of any unsold lot in Heritage Estates.*" As with Lots 5 and 6, each half of Lot 34 was permanently joined to the respective adjacent lot. The two halves of Lot 34 continue to individually exist in the county's parcels and tax records.

Also in 2005, the Developer merely mutually modified the boundary lines between the unsold Lot 8 and Lot 9 to incentivize the sale of Lot 8 by redefining an existing parking lot on Lot 9 as part of Lot 8. In this operation there was no combination by way of deed linkages, changes in dues obligations, net loss or gain of acreage, or change in the covenanted status of the lots.

It is noteworthy that the above-mentioned combination of the Lots 5 and 6 into a single tract/membership was effected by the Developer following the exact formula provided by the wording used in the Covenants/Declaration. **The initial purchase of multiple lots was carried out by permanently connecting the deeds of the two lots, and the buyers were subsequently obligated to build a house to have the lots considered one tract for the purpose of dues**. Similarly, the Developer's division and attachment of Lot 34 followed powers reserved in the Covenants/Declaration. The use of this language reflects the Developer's incentivizing intent that a single membership could be created buying multiple lots (at their first sale) and following this format. The Covenants retain their original language prohibiting subdividing or changing the boundaries of any lots (after the Developer had its initial sale). The Developer no incentive, and probably had no intent, to allow opening the door to members subsequently adding empty adjacent lots to their original home site with no dues obligation.

All lots in the development passed through their first sale before 1 January 2007. Heritage Estates, Inc. was legally dissolved mid-year, and HEPOA was formed in 2008, **ending the period of Developer control with 54 of the original 56 lot-based memberships intact**.

Three lot combinations subsequent to HEPOA 2008 formation

In re-organizing and reviewing the records of all HEPOA board meetings and financial records from 2008 to the present, there are three cases wherein members came to eventually own one or more lots adjacent to where their homes already stood, and then consolidated these lots by way of completing surveys and/or filing instruments of combination. The county's public records show that these took place in 2014 (Walls with consolidation of Lots 54, 55, and 56), in 2017 (Helms with Lots 4 and 7 being

consolidated with the above-mentioned Lots 5 and 6), and in 2020 (Landen with Lots 26 and 27 being combined). Each consolidated the adjacent lots, erasing lot boundaries and each leaving a single parcel and taxation record (Lots 6, 56, and 26, respectively).

None of these processes followed the Developer's methods (deeds permanently linking persisting parcels) or the sequence laid out in the Covenant's/Declaration (multiple lots bound together followed by house construction on the combined lots). Rather each case involved later purchases of adjacent unbuilt lots that were added to existing home sites by consolidation surveys or instruments.

Board involvement in the matter

There is no indication the post-Developer combinations were in any way covert or controversial. Rather the Board's lack of response seems to have been part of a wider general disconnect among the Board members with the exact terms and intent of our governing documents and state's HOA law, much like that seen elsewhere in our efforts to set straight numerous HOA matters (insurance, voting, annual budgets, reserve management, and financial procedures). In part this can probably be attributed to the correlation between our incorporation and the effects of the 2008/2009 real estate crash, which has been acknowledged as damaging Developer/HOA transitions across the country. For the next ten years, no houses were built in Heritage Estates and formalities referring to state law did not take hold.

In any case, the HEPOA Board of Directors did not formally discuss, review, or vote on accepting or rejecting ceased payment of dues for Lots 4, 7, 27, 54, and 55 between 2015 and 2021. Discussions that took place seem to have been informal and clearly simply assumed that dues reduction by combination were valid. The Treasurer billed the holders of the consolidated lots as a single lot at the beginning of the next calendar year.

Had the Board considered the matter formally, it might have become obvious there were conflicts of interest to resolve. Two of the members consolidating their lots were Directors at the time they consolidated, and the third was co-signing checks for the Treasurer, and then was appointed to the Board the year after their consolidation took effect.

It was also less than transparent to the Board and members as the reduced dues took effect in the Association's finances. Until 2019 Treasurer reports to the Board and membership followed a cash accounting method that did not include annual budgeting. Dues paid before January 1 were reported in the preceding year. Annual dues were always split into two reporting cycles. Other than the Treasurer reporting late or unpaid dues, the amount of dues reported for an operating year was not evident.

North Carolina laws and court decisions per HOA lot consolidations and dues reductions

Less than two years after the Heritage Estates original Covenants/Declaration was filed, a 2001 NC Supreme Court appeals decision (Claremont Prop. Owners Ass'n v. Gilboy, 142 N.C. App. 282, 542 S.E.2d 324, 2001) decided that extinguishing HOA per-lot fees by way of combinations put an undue burden on other lot owners. According to the Claremont decision, absent a specific provision to the contrary in the covenants, combining

of HOA lots does not alter the owner's obligation to pay dues/assessments (a real covenant that runs with the land). The lot owners in the Claremont case purchased previously combined lots but were subsequently ordered by the Court to retroactively pay separate dues per lot.

Although Heritage Estates' Covenant/Declaration seems to prohibit changing lot boundaries in any way after the tenure of the Developer, the Claremont decision noted that lot owners in North Carolina HOAs do have the right, for various reasons, to legally combine their lots. But Claremont was equally clear that such combinations alone cannot extinguish the inherent obligation to pay proportionately with other lot owners as covenanted on a per lot basis. Subsequent court decisions have affirmed these points (Fawn Lake Maintenance Commission v. Abers, 149 Wn. App. 318, Wash. Ct. App. 2009; Diercks v. Odom, Ex parte Odom, 254 So. 3d 222, 2017; Tanglewood Prop. Owners' Ass'n, Inc. v. Isenhour 254 N.C. App. 823, N.C. Ct. App. 2017). Furthermore, these cases have affirmed that the exact language and the intent of the original covenants and Developer must be considered (Haas v. Jurgis, 709 S.E.2d 601 N.C. Ct. App. 2011).

Summary

Our Heritage Estates covenants define each lot owner as a member and obligate them to pay dues on a per lot basis, resulting in proportionate sharing of the HOA budget per lot. The covenants do specify the conditions under which the Developer can combine lots and building a subsequent home on those lots can result in reduced membership obligations. Excepting these covenanted specifications, North Carolina case law has repeatedly clarified there is no general right for HOA members to extinguish lot dues simply by way of combination processes. Likewise, the right of all other HOA members to not carry a disproportionate share of the assessments has been repeatedly validated by the courts.

HEPOA presently has three owners of consolidated lots paying only a single set of dues on the assumption that consolidations with the county records reduce the obligations of multiple lots down a single lot. The lot manipulations made by the Developer in 2005 appear to be valid, given the powers reserved in the Covenants/Declaration. The post-Developer extinguishments seem much more open to question under the Covenants/Declaration, state law, and legal cases over the last 20 years. Resolution of this question is critical to the financial well-being of HEPOA.

The post-Developer cases described above currently deprive the HOA of $1500 per year (9% of its otherwise projected annual income). If these post-Developer extinguishments are valid, the practice will continue to be allowed. Under this model, current multiple ownership of the rest of the subdivision's lots, the dues for 21 other lots could be reduced to 9 dues payments (12 more lots extinguished). The total loss of dues would then be 31% of the amount our 54 post-Developer lots should be generating per year - a serious burden for the other owners to shoulder.