

## 52 N.J.R. 1257(a)

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### RULE PROPOSALS

#### Reporter

52 N.J.R. 1257(a)

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## Interested Persons Statement

### INTERESTED PERSONS

Interested persons may submit comments, information or arguments concerning any of the rule proposals in this issue until the date indicated in the proposal. Submissions and any inquiries about submissions should be addressed to the agency officer specified for a particular proposal.

The required minimum period for comment concerning a proposal is 30 days. A proposing agency may extend the 30-day comment period to accommodate public hearings or to elicit greater public response to a proposed new rule or amendment. Most notices of proposal include a 60-day comment period, in order to qualify the notice for an exception to the rulemaking calendar requirements of [N.J.S.A. 52:14B-3](#). An extended comment deadline will be noted in the heading of a proposal or appear in a subsequent notice in the Register.

At the close of the period for comments, the proposing agency may thereafter adopt a proposal, without change, or with changes not in violation of the rulemaking procedures at [N.J.A.C. 1:30-6.3](#). The adoption becomes effective upon publication in the Register of a notice of adoption, unless otherwise indicated in the adoption notice. Promulgation in the New Jersey Register establishes a new or amended rule as an official part of the New Jersey Administrative Code.

## Agency

COMMUNITY AFFAIRS >

DIVISION OF CODES AND STANDARDS

## Administrative Code Citation

Proposed Amendments: [N.J.A.C. 5:26-1.3](#), [8.6](#), and [8.7](#)

## Text

**Planned Real Estate Development Full Disclosure Act****Regulations**

Authorized By: Lieutenant Governor Sheila Y. Oliver, Commissioner, Department of Community Affairs.

Authority: [N.J.S.A. 45:22A-21](#).

Calendar Reference: See Summary below for explanation of exception to calendar requirement.

Proposal Number: PRN 2020-057.

Submit written comments by August 14, 2020, to:

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The agency proposal follows:

**Summary**

The Department of Community Affairs ("Department" or "Agency") proposes to amend the Planned Real Estate Development (PRED) Full Disclosure Act Regulations, [N.J.A.C. 5:26-8.6](#) and [8.7](#), to clarify the procedures for developing common expense assessments and budgets for developer-controlled boards, pursuant to [N.J.A.C. 5:26-8.4](#), in planned real estate developments. This rulemaking is the result of collaboration among the Department, the New Jersey Builder's Association (NJBA), and the Community Associations Institute of New Jersey (CAI). The purpose of these amendments is to codify requirements based on current policy and to ensure budgets are developed, common expense assessments are levied, and association monies are properly segregated, managed, and utilized in an identifiable and transparent manner. In addition, the proposed amendments specifically allow collection of a working capital contribution from a new member at closing, as a means of funding the start-up costs of the association. A section-by-section summary of the amendments follows:

[page=1258] 1. At [N.J.A.C. 5:26-1.3](#), a definition of "expandable project" would be added for clarity.

2. At [N.J.A.C. 5:26-8.6\(a\)](#), these amendments would specify when an association member may be required to make a working capital contribution in accordance with the governing documents of the association. The contribution is limited to a maximum of nine times the monthly common expense assessment for that particular unit at the time of closing. Proposed new [N.J.A.C. 5:26-8.6\(a\)1](#) would define working capital and delineate how those funds may be used; allowable expenses include those that could not be anticipated at the time the annual budget was adopted by the board. Proposed new [N.J.A.C. 5:26-8.6\(a\)2](#) would prohibit the developer-controlled association board from using the working capital to pay for budget line items, to minimize assessments needed for operation, or to lower the amount due from the developer to the association. Working capital contributions are collected to be used as the initial funds for an association. This new paragraph codifies the requirements based on current best business practices.

3. At [N.J.A.C. 5:26-8.6\(b\)](#), the amendment replaces general language on assessing units in relation to the benefit derived with a formulated basis on how common expenses would be assessed on both persons who have purchased units from the developer, and the developer for units still in the developer's possession. Subsection (b) is proposed for amendment to delete the concept of "benefit derived," because experience has demonstrated that it cannot be defined or applied uniformly, with the result that it has been a source of confusion and contention between developers and association members, often becoming the impetus for litigation during the transition period from developers to unit owners.

In its place, the amendments would specify that common expense assessments shall be made against "unit owners" and "developer units." The association's governing documents, which include the master deed, covenants and restrictions, and any applicable bylaws, rules, or regulations, shall direct the manner of payment and collection for common expenses, with each paying the proportion set forth in the governing documents of the association. It also establishes requirements if the developer elects to subsidize the common expenses for any budget year. Further, the subsection would create requirements if the common expense assessment results in either a year-end deficit or surplus, as determined through the annual audit of the association accounts. This would ensure that any deficit is satisfied by the developer and that any surplus is returned to owners and the developer based on their respective shares. Finally, this section would allow a special assessment to be made against the owners and developer in the event of an unforeseen or unanticipated circumstance.

4. At [N.J.A.C. 5:26-8.7](#), the section heading would be amended to "Budgets for Developer-Controlled Boards." The amendments at [N.J.A.C. 5:26-8.7](#), as part of this rulemaking, codify current policies, which ensure that developers prepare and adopt adequate budgets in a comprehensive and transparent manner.

5. At [N.J.A.C. 5:26-8.7\(a\)](#), the amendments would establish the requirements for reserve funds applicable to the common elements. This section requires the developer to prepare and adopt an annual budget that includes adequate reserve funds for the repair and replacement of common elements, equipment, and facilities. These amendments would define "adequate reserve funds" and establish what may be included in the replacement of a common element. These amendments would further require that an independent licensed engineer or architect determine the amount to be set aside for reserve funds. The section would specify where and how the funds might be kept to ensure that the funds are only used for the repair and replacement of common elements.

6. Proposed new [N.J.A.C. 5:26-8.7\(b\)](#) would require a new reserve study be prepared when the developer applies for an expandable project or the common elements or facilities differ from those shown on the

original site plans. An expandable project is any project that, at the inception, includes a certain number of buildings and units, but for which the developer has indicated that the project ultimately may be larger. This would ensure that any changes that may affect the reserve funds are accounted for. The cost of preparing a new reserve study would be the responsibility of the developer. This section would further establish that the cost of repair or replacement of common elements and facilities is to be a good faith estimate, including demolition, removal, and other associated costs. This section would also require the reserve study to be accompanied by a letter of adequacy signed and sealed by a licensed architect or engineer.

7. Proposed new [N.J.A.C. 5:26-8.7\(c\)](#) would require the association board to modify the budget in circumstances where unforeseen or unanticipated expenses affect the ability of the association to meet its current or ongoing financial obligations. When the developer is in control of the board, the amended budget must be submitted to the Agency within 30 days of its final adoption by the association board. The amendments would also establish requirements when the annual audit of the association funds identifies a discrepancy from the annual budget. [N.J.A.C. 5:26-8.7\(c\)2](#) would establish requirements in the event the annual audit of the association determines a different deficit than originally calculated; this would clarify when the developer must pay to satisfy the additional deficit.

8. Proposed new [N.J.A.C. 5:26-8.7\(d\)](#) would require the developer to provide a written statement to the unit owner-controlled board informing the board of the anticipated number of units to be closed and any new common elements to be constructed in the following budget year.

9. Proposed new [N.J.A.C. 5:26-8.7\(e\)](#) would establish how a budget is to be prepared when the developer maintains a majority of the association board based on the number of units anticipated to be under construction during the budget year, including units previously closed and units registered with the Department that were not conveyed to a purchaser.

10. Existing [N.J.A.C. 5:26-8.7\(b\)](#), (c), and (d) are proposed to be recodified as paragraph (e)2 and subsections (f) and (g). Amendments to these sections are proposed to update terms used in the existing text and for clarity, with no substantive change in requirements.

As the Department has provided a 60-day comment period on this notice of proposal, this notice is excepted from rulemaking calendar requirements pursuant to [N.J.A.C. 1:30-3.3\(a\)5](#).

### **Social Impact**

The proposed amendments are expected to have a positive social impact. This rulemaking would clarify existing rule text and ensure developers prepare and adopt budgets and formulate common expense assessments for community associations in a comprehensive and identifiable manner.

### **Economic Impact**

To the degree confusion about existing rule language has resulted in litigation between developers and unit owners, the revised language that fully identifies certain developer responsibilities should reduce litigation and associated costs. Beyond that, the Department does not anticipate that this proposed rulemaking will have any economic impact.

### **Federal Standards Statement**

No Federal standards analysis is required because the proposed amendments are not being proposed under the authority of, or in order to implement, comply with, or participate in any program established under Federal law or a State statute that incorporates or refers to Federal law, standards, or requirements.

### **Jobs Impact**

These proposed amendments would clarify existing rule text and ensure developers prepare and adopt budgets and formulate common expense assessments in community associations in a comprehensive and transparent manner. It is not anticipated that this will have an impact on the creation or loss of jobs.

### **Agricultural Industry Impact**

The Department does not anticipate that the proposed amendments, which address budgets and common expense assessments in community associations, would have any effect on the agricultural industry.

### **Regulatory Flexibility Analysis**

The proposed amendments would clarify existing rule text and ensure developers prepare and adopt adequate budgets and formulate common expense assessments in planned real estate development associations in a comprehensive and transparent manner. This rulemaking applies to developers of planned real estate developments, many of whom would be considered small businesses as defined by the New Jersey Regulatory Flexibility Act, [N.J.S.A. 52:14B-16](#) et seq. This rulemaking requires [page=1259] developers to employ the services of an independent licensed engineer or architect to prepare a reserve study to determine the amount of necessary reserve funds, as well as to prepare any new reserve studies that may be warranted based on the nature of the project. No additional recordkeeping requirements are imposed on the developers. This rulemaking is not expected to create hardship for developers of any size; thus, there is no basis for differential treatment of small businesses.

### **Housing Affordability Impact Analysis**

The proposed amendments are applicable to budgets and common expense assessments in community associations. It would not likely have an impact on housing production costs or affect affordability.

### Smart Growth Development Impact Analysis

The proposed amendments would address budgets and common expense assessments in community associations and would not be likely to have any impact upon housing production within Planning Areas 1 and 2, or within designated centers, under the State Development and Redevelopment Plan.

### Racial and Ethnic Community Criminal Justice and Public Safety Impact

The Department has evaluated this rulemaking and determined that it will not have an impact on pretrial detention, sentencing, probation, or parole policies concerning adults and juveniles in the State. Accordingly, no further analysis is required.

**Full text** of the proposal follows (additions indicated in boldface **thus**; deletions indicated in brackets [thus]):

#### SUBCHAPTER 1. GENERAL PROVISIONS

##### 5:26-1.3 Definitions

The following words and terms, when used in this chapter, shall have the following meanings, unless the context clearly indicates otherwise:

...

**"Expandable project" means a project that includes, at its time of registration under the Act, a certain defined number of units and common facilities, but that the developer anticipates, as indicated in its application for registration in accordance with the Act, that the project may ultimately be made larger by amendment, to include additional units, additional common facilities, or both.**

...

#### SUBCHAPTER 8. COMMUNITY ASSOCIATIONS

##### 5:26-8.6 Assessments for common expenses

(a) Until such time as the association shall make an assessment for common expenses, the developer, **while in control of the association**, shall pay all of the expenses of the common elements and facilities, **except as provided at (a)1i below. Upon acquisition of title to a unit, each new association member may be required to make a one-time, non-refundable and non-transferable, working capital contribution. The working capital contribution shall be assessed in accordance with the governing documents of the association, but in no event shall the working capital contribution exceed nine times the amount of the monthly common expense assessment for that unit at the time of closing. During developer control of the association's governing board, working capital funds shall be held in a separate account located in a bank that is FDIC-insured and authorized to do business in the State of New Jersey.**

**1. The intent of the working capital assessment is to provide the association with cash flow until the association begins receiving common expense assessments. Working capital assessment funds shall be used for one-time expenses limited to association startup operations. Startup operations may include on-site office equipment, utility deposits, and similar one-time expenses needed to establish an association, but shall not include any costs related to construction of a management office, or any expenses for off-site equipment.**

**i. Working capital assessment funds may be used to pay for unforeseen, unanticipated expenses in lieu of a special assessment. The term "unforeseen or unanticipated expenses" means those expenses that could not be reasonably anticipated at the time the annual budget was adopted by the association board. Unforeseen or unanticipated expenses shall not include: expenses that are normal or customary for the association and are the purpose for which the budget was adopted; expenses for capital improvements, reserves, or repairs to items of defective construction; or a budget deficit or a deficit in the association funds resulting from a difference between the number of units, pursuant to [N.J.A.C. 5:26-8.7](#), that the developer calculated would be closed during the year or the date by which such closings would occur and the number of units actually conveyed or the actual dates when closed.**

**2. While the developer maintains a majority of the association board, it shall not use funds from the working capital assessments to pay for budget line items, to minimize the assessments needed to operate the association, or to lower the amount due from the developer to the association.**

**(b) This subsection shall govern the assessment of common expenses.**

[(b)] **1. When the association has made a common expense assessment, the assessment shall be assessed against [the units individually owned and under development in proportion to the benefit derived by the unit from the items included in the budget.] :**

**i. Units that have been conveyed by the developer to owners (hereafter referred to as "unit owners").**

**ii. Units that have been registered with the Agency in accordance with the Act and this chapter (hereafter referred to as "developer units").**

2. Each unit owner shall pay a share of the common expense assessments, in the proportion set forth in the governing documents, for the full occupancy budget or the annual budget. The developer shall pay a full share of the assessments for all developer units, in the proportion set forth in the governing documents, for the full occupancy budget or the annual budget.

i. When the developer elects to subsidize the association common expenses for any given budget year, each unit owner, other than the developer, shall pay the share of the subsidized common expenses, in the proportion set forth in the governing documents, for the proposed budget or the annual budget.

ii. When the developer elects to subsidize the amount of each owner's total share of the budgeted assessment, this shall be disclosed in the full occupancy budget or the annual budget and set forth in a narrative statement in the "Special Notice" section of the public offering statement. The amount of the common expenses to be paid by the owners shall be referred to as the "Owners' Share." The amount of the subsidized common expenses to be paid by the developer shall be referred to as the "Developer's Share."

3. The association's governing documents shall provide for the manner of payment of common expenses.

i. When the developer elects to subsidize the association's common expenses for any given budget year, the developer shall be responsible for the payment of that portion of the common expenses that is the difference between the total common expenses and the Owners' Share. The Developer's Share of the common expense payments shall be paid no less frequently than the common expense payments due from unit owners.

ii. When the association board is controlled by unit owners, if the developer does not pay its share when due, the association shall have the same remedies as it does in connection with the collection of common expenses from the unit owners, as set forth in the governing documents.

iii. Except as provided in (b)5 below, when the association board is controlled by the developer, if the developer does not pay its share when due, the developer shall be required to make a lump sum payment for any unpaid budgeted common expenses before the start of the next budget year.

4. In the event that the assessment of common expenses results in a deficit in the operating fund of the association at the end of any budget year, the developer shall be responsible for satisfying such deficit. The developer shall make such payment within 60 days of the start of the new budget year.

[page=1260] i. The developer shall not be responsible for satisfying the deficit when it is the result of unforeseen, unanticipated expenses caused by conditions reasonably beyond the control of the developer, including, but not limited to, the situation in which the total amount of assessments unpaid by

unit owners exceed three percent of the budget. In such event, the developer-controlled board may use working capital to satisfy the deficit in accordance with the association's governing documents. Prior to using working capital, the developer-controlled board shall approve such use in a meeting open to the unit owners pursuant to [N.J.A.C. 5:26-8.12](#). The basis for the working capital being used under this subparagraph shall be set forth in the minutes of the board meeting.

5. In the event that the assessment of common expenses results in an operation fund surplus at the end of the budget year, the board shall recalculate the amount of assessments actually due from the owners and the developer based on their respective shares. The surplus shall be allocated among the unit owners and the developer in the same manner that the common expenses were assessed, either as a refund or a credit against future assessments. The decision to issue a credit or refund shall be determined by a vote of the unit owners, other than developer. If a quorum of unit owners cannot be reached, the association board shall be entitled to make the final determination whether to issue a refund or apply the surplus as a credit to future assessments.

6. The association board shall make the final determination of any deficit or surplus based upon the annual audit of the association funds.

7. In the event of an immediate need for additional funds to meet the association's financial obligations due to unforeseen, unanticipated conditions reasonably beyond the control of the developer (that is, force majeure), the board may impose a special assessment. The unit owners and the developer shall be obligated to pay their respective shares of the special assessment.

#### 5:26-8.7 Budgets for developer-controlled boards

(a) [The] **During developer control of the association's governing board,** the association shall, prior to making an annual assessment, prepare and adopt an operating budget, which shall provide, for any and all common expenses to be incurred during the **fiscal** year, as well as adequate reserve[s] **funds** for repair and replacement of the common elements and facilities.

1. Replacement of the common elements may include repair or replacement of a component of a mechanical system or facility necessary for the proper maintenance or operation of such system or facility.

2. "Adequate reserve funds" are those monies specifically dedicated for repair or replacement of common elements and facilities that have reached the end of the established useful life, based on the most recent reserve study, of each common element or facility, or one or more components of that element or facility, without the need for special assessments or loans. Contributions shall be established for common elements and facilities with useful lives, or remaining years of use, up to and including 30 years, and for roofs regardless of their useful lives.

3. The amount to be maintained in the reserve funds account shall be determined by an independent licensed engineer or architect as part of the reserve study.

4. During developer control of the association's governing board the following requirements shall apply:

i. Reserve funds shall be maintained in a segregated account in the name of the association and not comingled with other common expenses or capital contribution accounts.

ii. The account shall be located in a bank that is FDIC-insured and authorized to do business in the State of New Jersey.

iii. Following the election of the first unit owner to the board, and continuing until control of the association governing body is transferred to the unit owners, withdrawals from the reserve funds account shall require one signatory from the developer and one signatory from the owner-elected board members.

5. Reserve funds shall only be used for repair and replacement costs for which they are collected. A developer-controlled association board may not utilize reserve funds to repair or replace any common element unless:

i. The item that is sought to be repaired or replaced was included in the reserve study;

ii. The common element component to be repaired or replaced has exhausted not less than 90 percent of the useful life specified in the reserve study. In the event the common element component to be repaired or replaced has not exhausted 90 percent or more of its expected life, then a majority vote of a quorum of unit owners, other than the developer, as defined by the association governing documents, is required to utilize the reserve funds dedicated and maintained for the specific common element component's repair or replacement; and

iii. The reserve account has been fully funded in accordance with the association budget.

(b) A new reserve study shall be prepared in the following situations:

1. When a developer submits an application for an expandable project for registration in accordance with [N.J.A.C. 5:26-2.4](#). Each addition shall require an update to the reserve study to account for all new common elements and facilities to be constructed in each expansion phase and all

common elements and facilities constructed in prior phases where repair and replacement costs were not previously accounted for in the most current reserve study.

i. The developer shall bear the expense of the reserve study for common elements in any new phase; and

ii. The association shall bear the expense of any new common element added to a phase that is built out and sold out at the time of submission of the application to add a new phase.

2. Where the common elements and facilities differ from the common elements and facilities shown on the building plans or described in the public offering statement, a new reserve study shall be conducted. The public offering statement shall be amended, filed, and registered in accordance with [N.J.A.C. 5:26-4.5](#) to reflect the updated as-built common elements and facilities.

3. Based on the findings set forth in the most recent reserve study, the repair or replacement cost of those items classified as common elements and facilities in the governing documents shall be a good faith estimate of the cost to the association to repair or replace each item identified in the reserve study including demolition, removal, and other costs related to the repair or replacement of these items in current dollars.

4. The reserve study shall be accompanied by a letter of adequacy prepared by an independent licensed architect or engineer.

5. While the developer maintains control of the association board, the cost of any reserve study shall be the responsibility of the developer and shall not be classified as a common expense.

(c) Any deficit in the operating fund occurring during the budget year caused by unforeseen or unanticipated expenses shall be accounted for either by a determination by the association board that such unforeseen, unanticipated expenses do not materially affect the ability of the association to meet its current or ongoing financial obligations, or a determination by the association board that such expenses render the association unable to meet the association's current or ongoing financial obligations, in which case the association board shall modify the budget.

1. When the annual budget to be used is the full occupancy budget, then when modified, it shall be amended pursuant to [N.J.A.C. 5:26-4.5](#), prior to its use as the annual budget.

i. When the annual budget being used is other than the full occupancy budget, it shall be amended accordingly, and a copy of the revised budget shall be provided to the unit owners and the developer no later than 30 days prior to the start of the next budget year.

ii. When the developer is in control of the association board and still selling units in the ordinary course of business, the amended budget shall also be filed with the Agency as an amendment to the registration within 30 days of adoption of the budget.

[page=1261] 2. In the event the annual audit of the association determines a different deficit than originally calculated, the following shall govern:

i. When the association's final audit reveals that the deficit for the preceding budget year was greater than the amount previously calculated as of the year end, the developer shall pay to satisfy the additional deficit within 30 days following adoption of the final audit, except that portion attributable to unit owners' delinquency or unforeseen, unanticipated circumstances as set forth in the governing documents.

ii. When the deficit is less than the amount previously calculated, the association shall reimburse the developer the difference between the amount paid by the developer and the actual deficit amount.

(d) At least 60 days prior to the first day of the next budget year, the developer shall provide the unit-owner-controlled board with a written statement of the anticipated number of units to be closed during the next budget year and shall identify any new common element or facility anticipated to be placed in use during the next budget year.

(e) When the developer maintains a majority of the association board, the budget shall be prepared in accordance with this subsection.

1. In addition to the full occupancy budget required pursuant to [N.J.A.C. 5:26-4.2\(a\)](#)8, the developer shall prepare, or cause to be prepared, for each budget year an annual budget including all anticipated association operations, deferred maintenance, and replacement reserves. The annual budget shall be based upon the number of units anticipated to be under construction during the budget year, including units previously closed and units registered with the Agency, but not conveyed to a purchaser; and the reasonable expenses, taking into account the number of units anticipated to be under construction for the budget year and any common elements or facilities that were put into use during a prior budget year. All budgets prepared by the developer while it is in control of the board shall include an expense line item equal to three percent of common expenses to account for assessments unpaid by unit owners.

[(b)] 2. No budget prepared by the developer, or by the association board while under the control of the developer, shall contain any payment or subsidy by the developer that [artificially influences] **minimizes** the monthly assessment, unless the details are fully disclosed in the public offering statement **as a special notice** to the satisfaction of the Agency.

[(c)] **(f)** While the developer maintains [a majority] **control** of the executive board, the executive board shall have an annual audit of association funds prepared by an independent public accountant, a copy of which shall be delivered to each unit owner within 90 days of the expiration of the fiscal year of the association. The audit shall cover the operating budget, **capital reserve**, and **other reserve fund** accounts.

[(d)] **(g)** Until the expiration of any management contracts entered into while the developer maintains [a majority] **control** of the executive board, the developer shall [insure] **ensure** that a bond, or other guarantee acceptable to the Agency, is posted.

1. For the first year of operation, the bond or other guarantee shall be in an amount equal to the annual budget. For the second year and for succeeding years, the bond or other guarantee shall be in an amount equal to the annual budget plus accumulated **capital reserve[s] and other reserve funds.**

2. [The] **While the developer maintains control of the association board,** the developer shall provide the agency with [such] proof of such bond or other guarantee as may be necessary at the time of registration and annually thereafter.