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# **Sunrise Analysis: Condominium Association Managers**

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A Report to the  
Governor  
and the  
Legislature of  
the State of  
Hawai'i

Report No. 05-10  
December 2005



**THE AUDITOR**  
STATE OF HAWAI'I

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## Office of the Auditor

The missions of the Office of the Auditor are assigned by the Hawai'i State Constitution (Article VII, Section 10). The primary mission is to conduct post audits of the transactions, accounts, programs, and performance of public agencies. A supplemental mission is to conduct such other investigations and prepare such additional reports as may be directed by the Legislature.

Under its assigned missions, the office conducts the following types of examinations:

1. *Financial audits* attest to the fairness of the financial statements of agencies. They examine the adequacy of the financial records and accounting and internal controls, and they determine the legality and propriety of expenditures.
2. *Management audits*, which are also referred to as *performance audits*, examine the effectiveness of programs or the efficiency of agencies or both. These audits are also called *program audits*, when they focus on whether programs are attaining the objectives and results expected of them, and *operations audits*, when they examine how well agencies are organized and managed and how efficiently they acquire and utilize resources.
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4. *Sunrise analyses* are similar to sunset evaluations, but they apply to proposed rather than existing regulatory programs. Before a new professional and occupational licensing program can be enacted, the statutes require that the measure be analyzed by the Office of the Auditor as to its probable effects.
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# OVERVIEW

## *Sunrise Analysis: Condominium Association Managers*

Report No. 05-10, December 2005

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### Summary

In House Concurrent Resolution No. 204, the 2005 Legislature requested that the Auditor conduct a “sunrise” analysis of condominium association managers. A sunrise analysis performed in accordance with the Hawai‘i Regulatory Reform Act (Chapter 26H, Hawai‘i Revised Statutes) requires the Auditor to assess whether new or expanded regulation should be enacted in order to protect the health, safety, and welfare of consumers. Senate Bill No. 1454 of the 2003 legislative session proposed to regulate condominium association managers because of concern over their alleged lack of knowledge about condominium laws and operations. The bill defines condominium association managers as “any person employed or retained by a managing agent for the purposes of managing the operation of the property.”

Hawai‘i’s Condominium Property Act, Chapter 514A, HRS, governs condominium properties and their management. It enables a form of real estate ownership in which individual members hold title to a specific unit and have an undivided interest as a tenant-in-common with other owners in such common elements as the exterior of buildings, grounds, amenities, internal roads, and infrastructure. The law intends condominiums to be self-governing organizations. An elected board of directors of a condominium property has most of the power and responsibility for managing operations of the property. The law also provides for managing agents who are employed or retained to manage the operation of the property.

Currently, managing agents are regulated under Chapter 514A, HRS, and defined as any person employed or retained for the purposes of managing a property. They must be licensed as real estate brokers or corporations authorized to do business as trust companies, and they must maintain fidelity bonds based on the number of units managed of not less than \$20,000 and not more than \$100,000. However, the law also exempts any active real estate broker from the bonding requirements based on the belief that managing agents are licensed brokers and consumers who might be harmed would have recourse to the Real Estate Recovery Fund.

Senate Bill No. 1454 of the 2003 legislative session proposed a mandatory “certification” program for condominium association managers who are employed by managing agents. Before they can be certified, they must pass a test approved by the Real Estate Commission. The managing agent must register the condominium association manager with the commission and submit evidence that the manager has been certified.



The proposed regulation is unnecessary for several reasons. We found little evidence that condominium association managers have presented a danger to the health, safety, and welfare of the public. Most of the complaints filed at the Regulated Industries Complaints Office related to problems between condominium owners and their boards. In addition, complainants have many remedies available to them. Mediation services are available from the Real Estate Commission and the Regulated Industries Complaints Office. The Legislature has also established a Condominium Dispute Resolution Program that would allow cases that had not been resolved through mediation to be heard by the Commerce Department's Office of Administrative Hearing.

The recent recodification of the Condominium Property Law has addressed many condominium management issues, clarified the powers of the boards of directors, strengthened their enforcement powers, and defined conflicts of interest. It also imposes new bonding requirements of managing agents. The effective date of most of the changes will be July 1, 2006. It would be premature to consider any regulatory changes until the new law comes into effect and its impact on condominium management can be assessed.

For all the above reasons, the proposed regulation is not necessary. In addition, the designation "condominium association manager" is not a title that is commonly used in Hawai'i for those who work for managing agents. Also, the scope of certification is unclear and does not clearly distinguish among those who would be regulated and others who perform similar functions and would not be subject to regulation.

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## Recommendations and Response

We recommend that Senate Bill No. 1454, 2003 Regular Session not be enacted. The Real Estate Commission of the Department of Commerce and Consumer Affairs had no comments to offer at this time. The commission says that it acknowledges the complexities of community living and condominium governance and will be addressing these issues in its program of work.

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A Report to the  
Governor  
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Legislature of  
the State of  
Hawai`i

Conducted by

The Auditor  
State of Hawai`i  
and  
CRL Consulting, Inc.

Submitted by

**THE AUDITOR**  
STATE OF HAWAI`I

Report No. 05-10  
December 2005

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## Foreword

This “sunrise” report on condominium association managers was prepared in response to a provision in the Hawai‘i Regulatory Licensing Reform Act, Chapter 26H, Hawai‘i Revised Statutes, that requires the Auditor to evaluate proposals to regulate previously unregulated professions or vocations.

In House Concurrent Resolution No. 204 of the 2005 legislative session, the Legislature requested an analysis of Senate Bill No. 1454 of the 2003 legislative session that proposed to regulate condominium association managers. This evaluation, conducted by CRL Consulting, Inc., presents our findings and recommendation on whether the proposed regulation complies with policies in the licensing reform law and whether a reasonable need exists to regulate condominium association managers to protect the health, safety, or welfare of the public.

We wish to express our appreciation to the Department of Commerce and Consumer Affairs and other organizations and individuals that we contacted during the course of the evaluation.

Marion M. Higa  
State Auditor

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# Chapter 1

## Introduction

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This report on the proposed regulation of condominium association managers responds to a “sunrise” provision of the Hawai‘i Regulatory Licensing Reform Act—Chapter 26H, Hawai‘i Revised Statutes (HRS). The sunrise provision requires that, prior to enactment, legislative bills proposing regulation of previously unregulated professions or vocations be referred to the Auditor for analysis. The Auditor is to assess whether the proposed regulation is necessary to protect the health, safety, or welfare of consumers and is consistent with other regulatory policies in Chapter 26H. In addition, the State Auditor is to examine the probable effects of the proposed regulation and assess alternative forms of regulation.

Senate Bill No. 1454 of the 2003 legislative session proposed to regulate condominium association managers. The Legislature specifically requested an analysis of this proposal in House Concurrent Resolution No. 204 of the 2005 legislative session. Condominium association managers are defined in the bill as “any person employed or retained by a managing agent for the purposes of managing the operation of the property.” Property in this context means that belonging to an association of apartment owners. The Legislature sought to regulate these managers because of concern about their alleged lack of knowledge about condominium laws and operations.

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## Background

To better understand issues relating to community association managers, we provide some background on Hawai‘i law regarding condominium properties, current management models, current regulation relating to community association managers, the proposed regulation, and regulation in other states.

### ***Hawai‘i’s Condominium Property Act, Chapter 514A, HRS***

The issue of licensing condominium managing agents must be viewed within the context of Hawai‘i’s Condominium Property Act, Chapter 514A, HRS. The law is essentially a land ownership law, a consumer protection law, and a community governance law. It enables a form of real estate ownership in which individual members hold title to a specific unit and an undivided interest as a “tenant-in-common with other owners in such common elements as exterior of buildings, grounds, amenities, internal roads and infrastructure.”<sup>1</sup> It also protects purchasers through adequate disclosures, and finally, it manages the ongoing affairs of the condominium community.



In 2005, the Legislature repealed Chapter 514A. It enacted Act 164, Session Laws of Hawai‘i 2004, and Act 93, Session Laws of Hawai‘i 2005. These two acts resulted in the complete recodification of the State’s Condominium Property Law. Most of the provisions in the recodified law will take effect on July 1, 2006. Until then, Chapter 514A remains in effect.

Despite the recodification, the basic principles relating to the management of condominiums and the roles and responsibilities of those who manage condominiums remain the same. The guiding principle in the law relating to the management of condominiums is that the condominium community should be self-governing with minimal government interference.<sup>2</sup> This means that, to the extent possible, condominium owners are expected to manage and operate their own properties.

The system of governance is based on three documents: (1) the declaration, (2) the bylaws, and (3) house rules.<sup>3</sup> The declaration, which must be recorded in the State Bureau of Conveyances and the Land Court, describes the land and the buildings and the common elements. Common elements are the areas of a property in which owners have an undivided interest. The bylaws govern the operation of the property. They provide for such matters as the election of the board of directors, the directors’ terms, their powers and responsibilities, and their compensation. House rules usually govern only the use of the common elements.

The law provides that all of the apartment owners in a condominium be members of an association of apartment owners headed by an elected board of the directors. The board has most of the power and responsibility for managing operations for the property. The law also provides for “managing agents” who are employed or retained to manage the operation of a property. Operation of a property includes administration; fiscal management; and the maintenance, repair, and replacement of and the making of additions and improvements to the common elements.

### ***Condominium management in Hawai‘i***

Condominium associations generally operate under the following types of management models:

1. Self-management, in which most of the work is done by members of the association, is often the model used by small condominiums. In some larger properties, the board may hire a general manager as an employee who oversees all aspects of management. The general manager may hire employees or contract out for such functions as security, janitorial services, or grounds keeping services;

2. Partial management, with the board contracting out specific functions, such as landscaping and fiscal management, to outside firms; or
3. Retaining a managing agent as an independent contractor to oversee all aspects of the operations of the condominium.<sup>4</sup>

Properties are also managed under various combinations of the above. In addition, most of the larger condominiums also have resident managers. The resident manager usually lives on the property and handles day-to-day activities on-site such as enforcing house rules, doing or overseeing minor repairs, and scheduling major maintenance contracts. Depending on the size, nature of the association, and type of property involved, the respective duties and responsibilities of boards, managing agents, resident managers and other outside contractors may overlap or diverge.

In the past, condominiums were smaller properties managed by couples that lived on-site and handled all of the operational requirements for the property. As the number and size of condominiums grew, so did the need for more professional assistance with complex financial and administrative requirements. Today, managing agents offer a menu of management services from which associations can select. The fees charged by the managing agent depend on the number and types of services selected and the number of units on the property. A portion of the fees assessed homeowners pays for the managing agent's services.

These factors have made the management contract between the association and the managing agent of significant importance in determining the cost of management, how well the relationship works, and how well a property is managed. In effect, the board specifies in the contract which functions and responsibilities it intends to delegate to the managing agent. For example, an association might specify that the managing agent perform fiscal functions such as collecting fees from homeowners and preparing budget and financial reports, but not tax preparation or audit functions.

No data is available on the number of condominium managing agents in Hawai'i or their employees. In the past, the Department of Commerce and Consumer Affairs registered condominium managing agents. The department's last registration list for 2001-2003 showed 115 agents. The managing agent businesses range from single brokers to large companies that manage properties for over 400 associations statewide with over 50 managers; each manager may oversee several projects.

## ***Professional development***

Condominium management has evolved into a professional career for many. Competent managers are expected to be proficient in matters such as insurance, finance, applicable laws, governance, and communication. Many in the industry are interested in professional development and upgrading the occupation.

Two national organizations support professional development of condominium managers: the Community Associations Institute (CAI) and the Institute for Real Estate Management (IREM). CAI supports both community associations and their professional community managers with research, education, and other services. It has a professional certification program that awards progressive designations as managers advance in their experience, work, and knowledge. Managers qualify for the various designations through course work, having the requisite years of experience, and continuing education. These designations range from the beginning Certified Manager of Community Associations (CMCA) to the Professional Community Association Manager (PCAM), the highest professional recognition. The CMCA certifies that a manager has the necessary knowledge to manage any type of community association. About 100 managers in Hawai'i have one or more of the above designations. They see CAI certification as giving them greater credibility and professional status in their industry. CAI also conducts workshops, seminars, and other programs for community association members and managers.

The IREM focuses on real estate professionals and is an affiliate of the National Association of Realtors. It provides education, resources, information, and membership for real estate management professionals who work in multi-family and commercial real estate sectors. It also offers a progressive credentialing program based on coursework and experience. The credentials include the Certified Property Manager (CPM) designation, the Accredited Residential Manager (ARM) certification, and the Accredited Management Organization (AMO) accreditation. Currently, about 90 managers in Hawai'i have the ARM designation. Most of them work as resident managers.

## ***Regulation nationally***

At the present time, only a few states have licensing programs for community association managers. Prominent among them are Florida and Nevada. Florida law defines a community association manager as a person who is licensed by its Department of Business and Professional Regulation to perform community association management services. Community association management refers to services provided to properties of 50 units or more. It includes controlling or disbursing funds, preparing budgets and other financial documents, assisting in community association meetings, coordinating maintenance, and other day-to-day services for the operation of a community association.

The Florida law created an eight-member Regulatory Council of Community Association Managers to adopt rules relating to the licensure examination, continuing education requirements, fees, and professional practice standards.<sup>5</sup>

To be licensed, an applicant must file a complete set of fingerprints to be processed by state and federal law enforcement offices, be of good moral character, obtain prelicensure education approved by the department, and pass a licensure examination approved by the council. A licensed community association manager must also undertake ten hours of continuing education to obtain a biennial license renewal. Florida statutes also impose disciplinary proceedings such as revocation or suspension of licenses for violations of the law.

In addition, in 2004 the Florida Legislature created an Office of the Condominium Ombudsman.<sup>6</sup> The office is to provide education and assistance to condominium owners and to act as a liaison between owners and their managers and directors to resolve complaints and to facilitate the resolution of disputes. The office oversees the governance and regulation of over 18,000 condominium associations consisting of over 1 million condominium units.<sup>7</sup>

Nevada has a similar law. It established a five-member Commission for Common-Interest Communities. The commission is responsible for establishing education and other requirements for the certification of community managers. A community manager is defined as a person who provides for or otherwise engages in the management of a common-interest community.<sup>8</sup> No one is permitted to act as a community manager unless certified by the Commission. Nevada also established an office of Ombudsman for Owners of Common-Interest Communities.

### ***Regulation in Hawai‘i***

Chapter 514A, HRS, regulates only managing agents. They are defined in Section 514-A3, HRS, as “any person employed or retained for the purposes of managing the operation of the property.” Operation of a property includes “the administration, fiscal management, and operation of the property and the maintenance, repair, and replacement of, and the making of any additions and improvements to, the common elements.”

The law requires managing agents to be (1) licensed as real estate brokers or corporations authorized to do business under Article 8 of Chapter 412, HRS (trust companies) and (2) registered with the Real Estate Commission prior to conducting any managing agent activity. In addition, they must maintain fidelity bonds in amounts related to the number of units managed of not less than \$20,000 and not more than \$100,000. They must also pay application and registration fees and a fee to the Compliance Resolution Fund. However, the law also exempts any

active real estate brokers from these requirements, leaving only a handful of trust companies to be regulated. The exemption was based on the belief that managing agents are already licensed brokers and consumers who might be harmed would have recourse to the Real Estate Recovery Fund should harm occur.

***Proposed regulation of  
condominium  
association managers***

In House Concurrent Resolution No. 204 of the 2005 session, the Legislature requested that the Auditor conduct a sunrise analysis of the need to regulate condominium association managers as proposed in Senate Bill No. 1454, 2003 session. A “condominium association manager” is defined as any person employed or retained by a managing agent for the purposes of managing the operation of the property. The bill sought to impose a mandatory “certification” program that would require condominium managers to pass a test demonstrating a reasonable knowledge of condominium laws, operations, and management. In essence, it proposes that these practitioners be licensed before they can practice the occupation.

Concern over the lack of knowledge about condominium laws and operations led to S.B. No. 1454, 2003 session. It stated that unless condominium association managers are required to have the basic knowledge they need to do the job, the fundamental problems of condominium management would not likely be resolved. The bill notes that the State has no educational requirement for these practitioners. Therefore, no one responsible for operating or managing a condominium is required to have knowledge about the applicable laws. The bill planned to keep state involvement to a minimum by requiring only an examination on knowledge about condominium laws and management.

The proposed condominium association manager “certification” program is to be supported by a Condominium Management Education Fund. To be certified, a condominium association manager must pass an examination on condominium management and operations approved by the Real Estate Commission. The managing agent must register the condominium association manager with the commission and submit evidence that the condominium association manager is certified. The proposed legislation exempts those who have been managing a property for at least two years or hold an educational qualification approved by the commission. The bill allows the commission to charge fees for the requisite applications, examinations, and certificates, and for these fees to be deposited to a Condominium Management Education Fund.

The bill also amends the definition of a managing agent to specify that the agent is one who is employed as an independent contractor. This would exclude those who are employed as managers by self-governing condominiums. It expands the functions under the definition of

operation of the property” under Section 514A-3, HRS, to include, among other activities, overseeing and authorizing payments, offering managerial counsel to the association’s board of directors, developing budgets, soliciting bids for work to be performed, and supervising association personnel.

No testimony was presented on the bill since it did not receive a hearing.

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## Objectives

1. Determine whether there is a reasonable need to regulate condominium association managers to protect the health, safety, or welfare of the public.
2. Assess the probable effects of regulation, specifically the effects on condominium association managers.
3. Make recommendations, as appropriate, based on our findings.

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## Scope and Methodology

To assess the need to regulate condominium association managers as proposed in S.B. No. 1454, we applied the criteria set forth in Section 26H-2 of the Hawai‘i Regulatory Licensing Reform Act. The Legislature established these policies to ensure that regulation of an occupation occurs only when needed to protect consumers. Since regulation is an exercise of the State’s police power, it should not be imposed lightly. Its primary purpose is not to benefit the practitioners of the occupation who often seek regulation for reasons that go beyond consumer protection. For example, some practitioners believe that licensing will enhance their professional status and upgrade the occupation.

The consumer protection purpose of regulation is clearly articulated in Section 26H-2, HRS, amended by Act 45 of 1996. These policies state that:

- The State should regulate professions and vocations only where reasonably necessary to protect consumers;
- Regulation should protect the health, safety, and welfare of consumers and not the profession;
- Evidence of abuses should be given great weight in determining whether a reasonable need for regulation exists;

- Regulation should be avoided if it artificially increases the costs of goods and services to the consumer, unless the cost is exceeded by potential dangers to the consumer;
- Regulation should be eliminated when it has no further benefit to consumers;
- Regulation should not unreasonably restrict qualified persons from entering the profession; and
- Aggregate fees for regulation and licensure must not be less than the full costs of administering the program.

The national Council on Licensure, Enforcement and Regulation also offers guidance on the regulation of occupations. In its publication *Questions a Legislator Should Ask*,<sup>9</sup> the council says that the primary guiding principle for legislators is whether the unregulated profession presents a clear and present danger to the public's health, safety, and welfare. If the answer is no, regulation is unnecessary and wastes taxpayers' money.

In addition to regulatory policies in Chapter 26H, HRS, we used additional criteria for this analysis, including whether:

- The incidence or severity of harm based on documented evidence is sufficiently real or serious to warrant regulation;
- No alternatives provide sufficient protection to consumers (such as federal programs, other state laws, marketplace constraints, private action, or supervision); and
- Most other states regulate the occupation for the same reasons.

In assessing the need for regulation and the specific regulatory proposal, we placed the burden of proof on proponents of the measure to demonstrate the need for regulation. We evaluated their arguments and data against the above criteria. We examined the regulatory proposal and assessed whether the proponents provided sufficient evidence for regulation. In accordance with sunrise criteria, even if regulation *may* have *some* benefits, we recommend regulation only if it is *demonstrably* necessary to protect the public.

We scrutinized the appropriateness and the regulatory approach taken by the proposed legislation. Three approaches are commonly taken to occupational regulation:

- *Licensing*, the most restrictive form, confers the legal right to practice to those who meet certain qualifications. Penalties may be imposed on those who practice without a license. Licensing laws usually authorize a board that includes members of the profession to establish and implement rules and standards of practice.
- *Certification* restricts the use of certain titles (for example, social worker) to persons who meet certain qualifications, but it does not bar others who offer such services without using the title. Certification is sometimes called *title protection*. Government certification should be distinguished from professional certification, or credentialing, by private organizations. For example, social workers may gain professional certification from the National Association of Social Workers.
- *Registration* is used when the threat to the public health, safety, or welfare is relatively small or when it is necessary to determine the impact of the operation of an occupation on the public. A registration law simply involves having practitioners enroll with the State so that a roster or registry is created and the State can keep track of practitioners. Registration may be mandatory or voluntary.

In addition to assessing the need for regulation and the specific legislative proposal, we considered the appropriateness of other regulatory alternatives. We also assessed the cost impact on the proposed regulatory agency and the regulated group.

To accomplish the objectives of our analysis, we searched the literature on condominium association management and managers, including relevant regulation in other states, and Hawai‘i statutes and rules. We conducted interviews with representatives of the Community Associations Institute, the Hawai‘i Council of Associations of Apartment Owners, the Institute for Real Estate Management, the Hawai‘i Independent Condominium and Cooperative Owners, and the Mo‘ili‘ili Resident Managers Association. We also interviewed management personnel of the two larger managing agent companies and others, such as attorneys, who have been involved in condominium management and its regulation. We reviewed complaints filed at the Regulated Industries Complaints Office of the Department of Commerce and Consumer Affairs between January 1, 2003 and August 31, 2005. We conducted our assessment from July 2005 to September 2005.



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# Chapter 2

## Regulation of Condominium Association Managers Is Not Necessary

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We found that there is little evidence of harm to consumers or that fundamental problems in condominium management are the result of the lack of knowledge about condominium laws and operations on the part of managers. Consumers also have many remedies available to them. In addition, Hawai‘i’s Condominium Property Law was recently recodified. It would be premature to make additional changes to the law before it can be determined how the new law will impact condominium management.

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### Summary of Findings

Regulation of condominium association managers is not warranted.

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### Little Evidence of Harm

The Hawai‘i Regulatory Reform Act clearly states that regulation should be undertaken only when necessary to protect the health, safety, and welfare of consumers. Senate Bill No. 1454 contends that fundamental problems of condominium management cannot be resolved unless condominium managers are required to have the basic knowledge they need to do their jobs. We found little evidence that consumers are being harmed because condominium association managers may lack knowledge about state condominium laws and operations. Instead, complaints are often generated by the complexities of community living and their governance.

### *Complaints unrelated to condominium association managers*

We found few complaints relating to condominium managing agents. Complaints from residents of condominiums arise from the peculiarities and complexities of community living and condominium governance. Condominiums are designed by law to be self-governing entities. Each property may be a multi-million dollar asset owned by hundreds of homeowners. These homeowners consider the properties to be their personal homes in which they have a personal interest and emotional attachment. At the same, they must comply with a community system of governance that restricts what they may do in their homes and surroundings. In this system, responsibility for governance is distributed among a number of different players, and it is from the interplay among these players that management challenges and complaints stem.

## ***Management challenges***

Condominium management is a process that is fraught with the potential for miscommunication and misunderstanding even with the most diplomatic and competent of players. The players involved include the *board of directors*, which is responsible for decision-making and management; the managing *agents*, who assist the board with professional advice and services; *managers and other staff*, who service the individual properties; and the *resident manager*, who carries out the day-to-day tasks of maintaining the property, supervising staff, providing information and assistance to residents, and enforcing covenants and house rules. However, these players have roles and responsibilities that may vary with each property and with their relative strengths and weaknesses.

The interplay among these different players is often further complicated by the needs and demands of individual homeowners who may have little understanding of the respective roles of all involved. The board and homeowners often expect the manager to do more than what is delineated in the management agreement. Some boards may become over-involved in areas in which they lack expertise. The manager may or may not have sufficient authority to operate the property. In addition, managers have the problem of being supervised by a volunteer body that may not be sufficiently knowledgeable to oversee them adequately.

The condominium management industry is highly competitive and operates with a small profit margin. Those in the industry say that condominium management is demanding, stressful, full of pitfalls, and not highly compensated. Managing agent companies say it is difficult to find people who are willing to stay with the job. The average pay of a Hawai'i manager who services several condominium properties is reported to be about \$50,000.

## ***Few complaints***

Given the large number of condominiums, we found surprisingly few complaints and few records of disputes. We reviewed complaints filed at the Regulated Industries Complaints Office (RICO) of the Department of Commerce and Consumers Affairs and those referred to mediation.

### **RICO Files**

A review of complaints filed at RICO showed that eight complaints about managing agents were filed in 2003 and six in 2004. Between January and August 2005, a total of 137 cases relating to real estate were filed. Only 6 of the 137 related to managing agents. Four of these six were related to one case. Most of the complaints filed between 2003 and 2005 related to accounting for funds and fees. Only two related to incompetence, and they are still under investigation.

## Mediation

Both the Real Estate Commission and RICO have contracts for mediation services to which they can refer complainants. Mediation services are subsidized by the Condominium Education Fund and are available through the Mediation Center of the Pacific, Inc. on O‘ahu and mediation services on the Neighbor Islands. Between July 1, 2004 and February 28, 2005, a total of 12 cases were referred for mediation. Of these, nine were closed without mediation, one was withdrawn, and two were mediated. All of the cases were disputes between owners and their boards of directors. They related to renovations or damages to the owners’ property due to water or mold, incorrect citations, and so on. None of the disputes related to the lack of knowledge on the part of condominium association managers.<sup>1</sup>

## Condo court

In Act 164, Session Laws of Hawai‘i (SLH) 2004, the Legislature established a Condominium Dispute Resolution Pilot Program. The program would allow certain types of governance disputes that had not been resolved by mediation to be heard by the department’s Office of Administrative Hearing. The act restricted the types of disputes that could be heard. For example, disputes relating to the interpretation of an association’s declaration, bylaws, or house rules could not be brought for hearing.

During the 2005 legislative session, the Legislature found that no request for hearings had been filed with the pilot program. The Legislature then adopted Act 92, SLH 2005, which removed the limitation on the issues that might be adjudicated administratively. The act now allows the hearing officer to include any matter that had been the subject of mediation.

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## Proposed Regulation Unnecessary

We find that it is unnecessary to enact Senate Bill No. 1454 for several reasons. First, as the preceding section demonstrates, there is little evidence that consumers have been harmed because of the lack of knowledge on the part of condominium association managers. Second, the scope of regulation proposed by the bill is unclear. It proposes to regulate *condominium association managers* but exactly who they are and what they do is not defined in the bill. Third, the industry is sufficiently mature and competitive so that consumers have a choice. Professional designations awarded by industry organizations provide sufficient guidance to consumers regarding the qualifications of managers. Finally, the recent recodification of Hawai‘i’s Condominium

Property Law made a number of changes that should clarify and resolve management issues.

### ***Unclear scope of certification***

Senate Bill No. 1454 seeks to impose a “mandatory certification” program. It says that this is not licensing but purely an education program. However, since anyone who is employed by a managing agent in operating a condominium must be certified, it is, in effect, a licensing program.

Any proposal to license should define clearly the scope of practice that needs to be regulated to protect consumers. It should be possible to distinguish between those who fall within the scope of practice and must be licensed and those who do not. Without a clear scope of practice, the distinction cannot be made and it would not be possible to identify the requirements that should be imposed to prevent harm.

Senate Bill No. 1454 suffers from an unclear scope of practice. The bill seeks to regulate “condominium association managers” who are defined as any person employed or retained by a managing agent for the purposes of managing the operation of the property. However, the scope of practice of those employed by managing agents does not come neatly packaged. The activities of managing agents and their staff often overlap with those of general managers, and resident managers. The definitions in the proposed bill seek to single out and regulate an occupation that, in practice, is not readily distinguishable thus excluding some who perform similar functions and including others who do not. For example, the bill would not regulate those managing agents who perform the same functions but have no employees. It would also not regulate general managers who are employees of large condominium properties who also perform the same functions. In addition, it is unclear whether other employees of managing agents who perform such functions as accounting or assisting at board meetings would be subject to regulation. Consumers may believe certain types of practitioners are regulated based on the duties they perform when they are not.

### ***Unclear title designation***

Designations used in the condominium management industry do not correspond with terminology in Senate Bill No. 1454. The designation “condominium association manager” is not one that is commonly used in Hawai‘i for those who manage condominiums. Thus, the general public and those in the industry do not associate the designation “condominium association manager” with someone having a particular set of practices and abilities. Some of those in the managing agent business call their managers *account executives*. Other companies call them *property managers*. Interviews conducted with those in the industry reveal some confusion about exactly whom it is that the bill seeks to regulate. Some

of those interviewed believe that the bill intends to regulate both managing agents and any of their staff who work with the boards of associations to manage condominiums. Others believe that the term refers to resident managers or those who work for individual condominiums.

***Marketplace offers solutions***

Boards have the power to hire and dismiss condominium managing agents and their resident managers if they find their performance to be unsatisfactory. The latest Yellow Pages directory lists over 140 firms under “Real Estate Management,” indicating the competitiveness of Hawai‘i’s market and the choices available. A conscientious board has many ways to assess which companies provide sound professional services. Word of mouth works well in Hawai‘i. Boards can review the credentials and other professional qualifications of the staff of managing agents. They can also ask for testimonials and follow-up on them.

***Many remedies available***

Consumers who believe that managers have harmed them have many remedies available to them. They can file a complaint with the department’s Regulated Industries Complaints Office. The office’s investigators will examine and follow up on the case. Consumers can ask for mediation. Both the Real Estate Commission and the Regulated Industries Complaints Office have contracted for mediation services by neutral, nonprofit agencies such as the Mediation Center of the Pacific. Consumers who are dissatisfied with mediation can continue with a request for an administrative hearing. In addition to these avenues, the recent recodification of Hawai‘i’s Condominium Property Law has put more teeth into the consumers’ ability to recover money from managing agents.

***New bonding requirements***

Under Act 64, SLH 2004, to be effective July 1, 2006, misconduct by employees of managing agents (those targeted for regulation under Senate Bill No. 1454) would be covered under a fidelity bond to be obtained by the managing agent. Under the current Chapter 514A, HRS, managing agents are exempt from registration and bonding requirements. The rationale was that all managing agents must be licensed and active real estate brokers. As such, consumers would have access to the Real Estate Recovery Act for any act of fraud, misrepresentation, or deceit by managing agents. They could recover up to \$25,000.

The recent recodification continues to exempt licensed, active real estate brokers from registration requirements but intentionally does not exempt them from the requirement to be bonded. When the law takes effect, managing agents will be required to retain a fidelity bond in an amount equal to \$500 multiplied by the aggregate number of units in the property

managed. The bond shall be not less than \$20,000 or more than \$500,000. The bond is intended to protect the managing agent against the loss of any association's moneys, securities, or other properties caused by fraudulent or dishonest acts of employees of the managing agent.

The Real Estate Commission made this change based on the following consideration: "At least part of the theory behind exempting licensed, active real estate brokers from the registration and fidelity bond requirements of this section is that victims of such real estate brokers would have recourse against the Real Estate Recovery Fund.... Such a remedy however, is woefully inadequate as a few 'bad acts' involving large condominiums managed by such real estate brokers could easily result in claims exceeding available recovery fund monies. The exemption from the fidelity bond requirements for licensed, active real estate brokers has been deleted...."<sup>2</sup>

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## **Change Is Premature**

The recent recodification under Act 164, SLH 2004 and Act 93, SLH 2005 makes any further change premature. In Act 93, SLH 2005, the Legislature completed the recodification of the Condominium Property Law. Among other changes, the law addressed condominium management issues, clarified the powers of the boards of directors, strengthened their enforcement powers, and defined conflicts of interest. It imposes new bonding requirements on managing agents and it also expands the issues that may be considered in administrative hearings of condominium disputes. The effective date of most of the provisions of the law will be July 1, 2006. It would be premature to consider any regulatory changes until the new law comes into effect and its impact on condominium management can be assessed.

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## **Conclusion**

We found little evidence that problems in condominium management are the result of the lack of knowledge of condominium law and operations on the part of condominium managers. We found few complaints and consumers have several avenues available to them to resolve disputes. Finally, the recent recodification of the State's Horizontal Properties Regimes Law makes any additional change at this time premature.

### **Recommendation**

We recommend that S.B. No. 1454, 2003 Regular Session not be enacted.

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## Notes

### Chapter 1

1. Gordon M. Arakaki, *Recodifying Hawai'i's Condominium Property Regimes Law*, Condominium Recodification Attorney, Real Estate Commission, State of Hawai'i, July 16, 2002.
2. Hawai'i Real Estate Commission, *Final Report to the Legislature, Recodification of Chapter 514A Hawai'i Revised Statutes (Condominium Property Regimes) In Response to Act 213, Section 4 (SLH 2000) December 31, 2003*, Hawai'i Real Estate Commission, Professional and Vocational Licensing Division, Department of Commerce and Consumer Affairs, December 31, 2003.
3. Information on condominium governance is largely drawn from *Director's Guide to Hawai'i Community Association Law*, prepared by John A. Morris, Ashford and Wriston, Honolulu, Hawai'i, 2004.
4. Peter C. Behrens, *Condominium Management in Hawai'i – The Role of the Management Agreement*, Hawai'i Real Estate Research and Education Center, University of Hawai'i, Honolulu, Hawai'i, December 1990. Also, Randall K. Sing and Melvin M. Sakurai, *Condominium Management: Manager Regulation and Licensing; Education of Board Members*, A Report for the Hawai'i Real Estate Commission, December 1991.
5. Florida Statutes, Chapter 468, Part VIII.
6. Florida Statutes, Chapter 718.5011.
7. Florida Office of the Condominium Ombudsman, *Condominium Ombudsman Quarterly Report, January through March 2005, May 9, 2005*.
8. Nevada Revised Statutes, Section 116.615
9. Benjamin Shimberg and Doug Roederer, *Questions a Legislator Should Ask*, Second Edition, The Council on Licensure, Enforcement and Regulation, Lexington, Kentucky, 1994.



## Chapter 2

1. “Mediation Case Summaries, *Hawai‘i Condominium Bulletin*, March 2005, p. 7.
2. Real Estate Commission, *Final Report to the Legislature, Recodification of Chapter 514A, Hawai‘i Revised Statutes (Condominium Property Regimes) in Response to Act 213, Section 4 (SLH) 2000, December 3, 2003, Final Draft*, p. 19.

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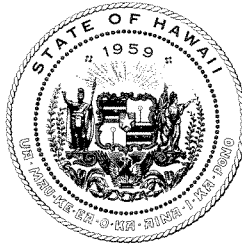
## **Response of the Affected Agency**

### **Comments on Agency Response**

We transmitted a draft of this report to the Department of Commerce and Consumer Affairs on December 13, 2005. A copy of the transmittal letter to the department is included as Attachment 1. The response of the Real Estate Commission of the department is included as Attachment 2.

The commission had no comments to offer at this time. It acknowledged the complexities of community living and condominium governance and will be addressing these issues in its work program.

STATE OF HAWAII  
OFFICE OF THE AUDITOR  
465 S. King Street, Room 500  
Honolulu, Hawaii 96813-2917



MARION M. HIGA  
State Auditor

(808) 587-0800  
FAX: (808) 587-0830

December 13, 2005

**COPY**

The Honorable Mark E. Recktenwald  
Director  
Department of Commerce and Consumer Affairs  
King Kalakaua Building  
335 Merchant Street  
Honolulu, Hawai'i 96813

Dear Mr. Recktenwald:

Enclosed for your information are three copies, numbered 6 to 8, of our confidential draft report, *Sunrise Analysis: Condominium Association Managers*. We ask that you telephone us by Thursday, December 15, 2005, on whether or not you intend to comment on our recommendations. If you wish your comments to be included in the report, please submit them no later than Monday, December 19, 2005.

The Governor, and presiding officers of the two houses of the Legislature have also been provided copies of this confidential draft report.

Since this report is not in final form and changes may be made to it, access to the report should be restricted to those assisting you in preparing your response. Public release of the report will be made solely by our office and only after the report is published in its final form.

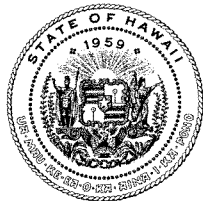
Sincerely,

Marion M. Higa  
State Auditor

Enclosures

LINDA LINGLE  
GOVERNOR

JAMES R. AIONA, JR.  
LIEUTENANT GOVERNOR



MARK E. RECKTENWALD  
DIRECTOR

NOE NOE TOM  
LICENSING ADMINISTRATOR

STATE OF HAWAII  
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December 16, 2005

RECEIVED

Ms. Marion M. Higa  
State Auditor  
Office of the Auditor  
465 South King Street, Room 500  
Honolulu, HI 96813-2917

2005 DEC 19 AM 8:31

OFC. OF THE AUDITOR  
STATE OF HAWAII

Dear Ms. Higa:

We appreciate the opportunity to review and comment on your preliminary report on the Sunrise Analysis: Condominium Association Managers.

The Real Estate Commission reviewed the report and its recommendations. We have no additional comments to offer at this time. The Commission acknowledges the complexities of community living and condominium governance and will address some of these issues in its program of work.

The Commission appreciates the State Auditor's role and the sunrise analysis process.

Very truly yours,

REAL ESTATE COMMISSION

Trudy I. Nishihara  
Chair