Don't take a vacation from the additional regulations that apply to Condominium Hotels

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Michigan has been blessed with the Great Lakes which has resulted in numerous condominium projects being developed on or near the water that are intended for daily or weekly use by temporary occupants. These condominium projects are often referred to as "Condominium Hotels", "Resort Condominiums", "Condotels" or "Vacation Condominiums" despite the fact that the Michigan Condominium Act creates no such specific classifications and Michigan does not have a "Condominium Hotel Act" as some other states have. For the purposes of this article, the author will refer to the aforementioned projects as "Condominium Hotels." Condominium Hotels have become increasingly popular in Michigan and are appealing as co-owners can vacation at their units and enjoy the same amenities and services offered at a resort or hotel. When the unit is not in use, a co-owner can earn additional income by utilizing the services of a rental management company to rent their unit or by renting the unit themselves. Given the increasing popularity of Condominium Hotels, associations, co-owners and management companies should be cognizant of the numerous legal issues that often arise in operating a Condominium Hotel that would not ordinarily exist for a condominium project composed of permanent residents. While this article is not an exhaustive list of the legal issues that Condominium Hotels face, it does discuss the most common issues that this author has observed.

1. Do the condominium documents allow for the operation of a Condominium Hotel?

Condominium Hotels often utilize a standardized set of condominium documents and the term "hotel" and/or "resort" is not used even one time in the master deed or bylaws. Given that the Michigan Condominium Act does not expressly recognize the existence of a Condominium Hotel, the condominium documents provide the basis for operating a condominium project as a Condominium Hotel and must specify that the condominium project is to be operated as such. Additionally, the disclosure statement prepared by the developer should also indicate that the condominium project is being operated as a Condominium Hotel as this would be material information that the developer is required to disclose. Moreover, in certain circumstances, if a developer is marketing a rental management program in connection with the

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sale of units, the developer may be engaged in selling a security. Accordingly, the developer may be required to register the security and provide a prospectus to potential purchasers under the Federal Securities Act. As such, associations, co-owners, developers and management companies must be aware that an ordinary set of condominium documents and disclosure statement will likely not meet the requirements of a condominium hotel project.

After determining that appropriate documentation is in place to operate a condominium hotel, an association should ensure that any rental/leasing restrictions contained in the condominium documents do not prohibit the rental of units as part of a rental management program. Often times condominium documents for Condominium Hotels contain the same rental/leasing restrictions as permanent residency condominium projects. Such restrictions often include provisions that require a co-owner to provide written notice to the association of potential lessees or occupants at least 10 days, sometimes as many as 30 days, in advance of occupancy, along with providing a copy of the lease for the association's review or providing the association with information regarding the occupant and the terms of the occupancy agreement as required by MCL 559.212. However, MCL 559.212 was clearly designed to impose requirements on renting and leasing in permanent residency condominium project when a landlord/tenant relationship is created. Just as the Michigan Condominium Act should be amended to include a specific classification for Condominium Hotels, MCL 559.212 should be amended to clarify that it has no application to Condominium Hotels. However, until this happens, the condominium documents should be carefully drafted so the co-owners can participate in a rental management program after providing appropriate notice. Similarly, the condominium documents should also ensure that the Association is provided and/or has access to the name, address, rental rate, and date of payments for each rental in order to ensure compliance with MCL 559.212.

2. Does the rental management company have a real estate license?

The Michigan Occupational Code requires that an individual or corporate entity engaged in "property management" hold a real estate license. MCL 339.2501(e) defines property management as "the leasing or renting, or the offering to lease or rent, of real property of others for a fee, commission, compensation, or other valuable consideration pursuant to a property management employment contract." In a permanent residency condominium, a management company often times does not need to possess a real estate license as it does not rent units on behalf of the co-owners but rather only handles the day to day operations of the Association. In contrast, a Condominium Hotel often hires a rental management company to administer the rental management program and rent the units on behalf of the co-owners in exchange for a fee pursuant to a contract. As such, the plain language of MCL 339.2501(e) requires a rental management company for a Condominium Hotel to possess a real estate license.

Despite the fact that MCL 339.2501(e) is clear on its face, the Michigan Department of Licensing and Regulatory Affairs ("LARA") has adopted an informal policy in which it has chosen not take enforcement action against unlicensed rental management companies as long as they do not rent for a period of more than six (6) months. However, given that LARA's informal policy is contrary to the plain language of MCL

339.2501, and is subject to change at any time, the best practice is to hire a licensed rental management company. Adherence to LARA's informal policy would only prevent administrative action being taken by LARA, and would not operate to bar civil liability if a co-owner were to sue the association and/or rental management company for allowing unlicensed rentals. Potential liability for allowing unlicensed rentals could include having a court issue an injunction to prevent the continued operation of an unlicensed rental management program, awarding attorney's fees and costs to any co-owner that obtains an injunction to prevent an unlicensed rental program and/or requiring the unlicensed management company to disgorge any fees earned as a result of unlicensed rentals, in addition to any other damages incurred by the co-owners. As such, a rental management company should not operate without a license and an association should only hire a rental management company that is licensed.

3. Can the association self manage a rental management program?

In the context of permanent residency condominium projects, some associations do not hire management companies as they opt for self management. However, the association for a condominium hotel should be mindful that it should not be self managing a rental management program as it is contrary to their status as a nonprofit corporation. The Michigan Nonprofit Corporation Act clearly provides that a nonprofit corporation may be "incorporated to carry out any lawful purpose or purposes not involving pecuniary profit or gain for its directors, officers, shareholders, or members." MCL 450.2108(3). Consequently, operating a rental management program for a profit would be a violation of MCL 450.2108.

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Moreover, an association would still be subject to the same real estate licensing requirements as discussed above. If an association were to engage in "property management" it would be required to hold a real estate license. As a practical matter, this would be extremely difficult in the context of a condominium association, as MCL 339.2508(2) requires each principal of a corporate entity apply for and obtain a real estate license if a corporate entity holds a real estate license. Given that the directors and officers of an association routinely change after each election, it would be extremely impractical to have the various co-owners that serve as the directors and officers obtain a real estate license as a requirement of holding their positions. As such, while the association is certainly free to self manage its day to day operations, as a real estate license is not required for these activities, an association should not administer its own rental program.

4. What other issues should the Association be mindful of in hiring a rental management company?

The Association, through its board, owes a fiduciary duty to the co-owners to hire a qualified rental management company. Just as with hiring any other vendor, the association should obtain multiple quotes from rental management companies and investigate the qualifications of each management company before selecting one. This is important as the author of this article has seen rental management companies that charge anywhere from a six percent (6%) to a fifty percent (50%) commission for renting co-owner units. In comparing the quotes, an association should also compare the services offered by each rental management company as these may vary as well. Additionally, it is not uncommon that a

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developer will setup a rental management company and attempt to require the co-owners to use the developer's management company. Such situations are rife with a conflict of interest and an association should implement measures to ensure that self interested directors do not hire a rental management company for their own benefit at the expense of the association's best interest.

In selecting a rental management company, the association should also inquire as to whether the rental management company has an equitable method of distributing rentals and rental income. Co-owners often question whether their unit is being rented as often as a developer owned unit, if the developer remains involved in the project, or as often as their fellow co-owners. While there are numerous variables that are involved in whether a co-owner's unit is rented, which include the amount of use by the co-owner, type of room, view, etc., the rental management company must employ something more than guesswork in allocating the rentals. The association should also ensure that the co-owners have a means of verifying whether the rentals and rental income are equitably distributed and should not hire a rental management company that cannot provide verification of the same.

The association should also ensure that the rental management company keeps separate accounts and that rental revenues are segregated from the association's funds. This is important in order to avoid blurring the lines between association expenses, which are to be paid from assessments, and rental management program expenses, such as advertising, promotional materials, rental management fees, etc. which should be paid from the rental revenues. If the association's and rental management program's funds are comingled, the association and/or management company may use assessments for unauthorized rental management program expenses, which subjects the association's board members and the management company to liability.

While the Great Lakes have created great opportunities for the development of condominium hotels in Michigan, the Condominium Hotel concept has also created many new legal issues. While states such as Nevada have a "Condominium Hotel Act", Michigan law has thus far been behind the curve in developing a statutory scheme to govern Condominium Hotels. As such, associations, co-owners, developers and management companies must be aware of the various laws that apply to Condominium Hotels which are not applicable to a traditional condominium project composed of permanent residents. As the Condominium Hotel concept continues to increase in popularity, the body of law governing Condominium Hotels will continue to develop in Michigan as well. However, as this body of law governing Condominium Hotels develops, associations, co-owners, developers and management companies should ensure that the current rules do not go on vacation just because the guests are. ■

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