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Recent Case Law Does Not Doom All Rental Restriction Amendments

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The North Carolina Court of Appeals recently released two cases that raise the question of whether a covenant amendment containing rental restrictions may be adopted by a condominium association or homeowners association.

Both cases – Mileview LLC, et al. v. The Reserve II at Sugar Mountain Condominium Owners Association (February 2024) and McDougald v. White Oak Plantation Homeowners Association, Inc. (August 2024) – are unpublished decisions, meaning they lack precedential value in future cases. Despite the fact these cases are not binding precedents, they are insightful. They show how the Court of Appeals views rental restriction amendments in certain contexts.

Both cases apply the *Armstrong v. Ledges Homeowners Association, Inc.* standard that amendments must be reasonable. *Armstrong* is a 2006 North Carolina Supreme Court case that established the lens by which future amendments must be considered by a court. The two recent Court of Appeals cases mentioned above strike down rental restriction amendments as unreasonable by applying the "reasonableness test" under *Armstrong*.

Some stakeholders active in the community associations space now believe these cases indicate that all rental restriction covenant amendments will fail. This is not the lesson of the *Armstrong* case, and these recent unpublished cases hardly suggest such an outcome. Undoubtedly, the North Carolina Supreme Court will need to weigh in on this topic again to explain how *Armstrong* should be rightfully applied to changing communities, new technology, and more refined covenants. But it is a far cry to say that all rental restriction amendments are dead. Here are five reasons why rental restriction amendments remain viable under the *Armstrong* standard, notwithstanding the recent unpublished decisions:

1. The *Armstrong* decision itself contemplates rental restriction amendments may be valid.

The *Armstrong* case dealt with amendments that gave broad assessment powers to the Ledges Homeowners Association when the association previously only had limited powers to charge assessments. It was a seismic change for that community. But, in evaluating these assessment amendments, the Supreme Court commented directly on how rental restriction amendments may be

viewed in the future, and it gave some examples:

> *For example, it may be relevant that a particular geographic area is known for its resort, retirement, or seasonal "snowbird" population. Thus, it may not be reasonable to retroactively prohibit rentals in a mountain community during ski season or in a beach community during the summer. Similarly, it may not be reasonable to continually raise assessments in a retirement community where residents live primarily on a fixed income. Finally, a homeowners' association cannot unreasonably restrict property rental by implementing a garnishment or "taking" of rents (which is essentially an assessment); although it may be reasonable to restrict the frequency of rentals to prevent rented property from becoming like a motel.*

Even though this language is not directly on point with the amendment at issue in *Armstrong*, it shows how the Supreme Court was not closing the door on all rental restrictions in the future. The last sentence specifically suggests that a rental restriction dealing with the "frequency of rentals" may be an appropriate amendment.

2. The reasons for the amendments may show reasonableness.

Doubters who are convinced the sky is falling on all rental restriction amendments fail to acknowledge that the *Armstrong* test remains one of reasonableness, which is a community-specific and covenant-specific analysis. Dictionaries generally define "reasonable" as something that is fair, that makes good sense, or that is appropriate. Under *Armstrong*, the reasonableness of the amendment will dictate whether it is valid. This does not mean every rental restriction imaginable would be unreasonable, even if the community has never had a rental restriction in the past. The reasonableness of an amendment will examine those characteristics that *Armstrong* directs a court to consider in assessing reasonableness, including the nature and character of the community, the covenants being amended, and the reasons for the amendments.

Two examples may be illustrative. First, a condominium may risk insurance carriers treating it differently due to the number of rentals in the community, so the condominium community may adopt a rental restriction amendment to limit the frequency of rentals in the condominium. If a condominium has always been a residential condominium but is at risk of losing its residential nature from the perspective of insurance carriers who provide insurance, a rental restriction to maintain the residential nature of the condominium in all aspects appears to be reasonable. This is maintaining the original nature of the condominium and what it was intended to be. It also is limiting the frequency of rentals to avoid being like a motel, something that *Armstrong* specifically contemplates. Second, a community may have covenant limitations on the use of lots by tenants already, and clarifying amendments to make definite, or to update, those limitations based on current usage and current terminology should be reasonable. Both examples should survive scrutiny under *Armstrong*.

3. The current restrictions may make an amendment reasonable.

A community that provides for different treatment of renters and the restrictions from the outset of the community and restrictions that dictate the nature of the community may support a rental restriction amendment. Older covenant language about "no transient occupancy" may not be enough, standing alone, but combining this type of language with covenant lease terms, owner-occupied restrictions, and other covenant terms declaring the non-rental nature of the community may be enough to uphold a rental restriction amendment.

4. Prior amendments to the restrictive covenants may show reasonableness.

One of the great misunderstandings of the *Armstrong* case that has been argued by advocates is that *Armstrong* requires a community to go back to its origins to evaluate the reasonableness of an amendment. That may be true in connection with a community that has not had amendments over the years, but a community that has amended its restrictive covenants should have the *Armstrong* reasonableness test applied to its current covenants in place at the time of the amendment subject to challenge. It is a misread of *Armstrong* to suggest that the original covenants should be the viewpoint by which an amendment's reasonableness is considered when a community has amended and restated its declaration, or had many applicable amendments, in the past. A community should not be forced to revert back to its 1970s restrictive covenants when prior amendments in the 2000s and 2010s have been validly adopted and not challenged during the statute of limitations provided for any such challenge. That type of analysis itself would be unreasonable, and it is certainly not what *Armstrong* intended.

A community that has applied rental restrictions through prior amendments should have the foundation on which to now amend its rental restrictions. It is reasonable for a community that has restricted rentals to put additional details and restrictions surrounding those earlier covenants. As the Supreme Court said in *Armstrong*, the purpose of an amendment is "to improve, make right, remedy, correct an error, or repair" a covenant. An amendment to "improve" the rental restrictions already in place should be viable under *Armstrong*.

5. Community consensus may avoid a challenge.

Any community considering a rental restriction amendment should first attempt to obtain consensus among the community members regarding the terms of the proposed rental restrictions. It is far better to avoid a potential rental restriction amendment lawsuit on the front end instead of suffering through the battle with the uncertainty of a court outcome. There are many arguments that a trial attorney can make in this space until the North Carolina Supreme Court gives guidance on the scope of *Armstrong*'s reasonableness test as applied to rental restrictions. If the community can obtain consensus, the odds of a challenge drop dramatically. It is a long and expensive battle for a group of owners to challenge a rental restriction amendment, and the more "buy-in" by the community members will make such a challenge less likely. Community consensus can be achieved by working through the least onerous rental restriction possible so the community's needs are met without imposing more burden than necessary on the owners who desire to rent. The scope of any amendment will be impacted by trying to achieve this consensus, and this is the type of effort that a court may find advantageous to the community association's argument on reasonableness. Evidence on committee actions to evaluate issues, community surveys or straw polls, and other input from the community members may show how this amendment is reasonable to the community. It also may limit or eliminate the potential for challenge. An experienced community association attorney can assist an association by suggesting steps to take to try to achieve consensus.

Conclusion

Challenges to rental restriction amendments remain a hot topic for litigation in North Carolina. Each community is different, so any rental restriction amendment that is being considered or that has been adopted should be separately evaluated to determine whether it passes the *Armstrong* reasonableness test. There is no bright-line rule that all rental restriction amendments will fail, but communities should be careful in considering these amendments.

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