



Transition of Control of the Community Association from the Unit Owners' Perspective

By Gary A. Poliakoff

The term "transition," as used in this article, is the process of transferring control of a statutorily mandated membership community association from the developer to the unit owners. The timing of transition can be contractual, with governing documents specifying a time. It can also be statutorily mandated. Nevada, for example, mandates that the period of developer control terminate no later than the earlier of 60 days after conveyance of 75% of the units, or five years after the developer has ceased to offer units for sale in the ordinary course of business, or five years after any right to add new units

was last exercised. NEV. REV. STAT. 116.31032 (1999).

As important as it is to understand what transition is, it is equally important to understand what it is not. Transition is not the act of ratifying the actions or decisions of the developer-controlled board, nor the carte blanche acceptance of the property, nor the waiver of any unit owner's or association's rights that might exist against the developer for warranties, representations, accounting claims, or other issues. In fact, some states, such as Florida, specifically toll the statute of limitations on claims that might arise from the development of a community

until transfer of control occurs. See FLA. STAT. ANN. ch. 718.124 (2000).

Why Developers Keep Control

One might ask why a developer would want to keep control of what is essentially the homeowners' associa-

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tion in the first place. There are a number of legitimate reasons, particularly during the period of developer control. They include:

- *Controlling the purse strings.* A developer-designated board has greater control over association expenditures and can prevent unnecessary capital projects from being bankrolled during the period of the developer's "maintenance guarantee."
- *Precluding litigation during the sales process.* Nothing is more detrimental to a developer's sale of housing units than litigation on the basis that the units are shoddy or that promised amenities were never delivered. Although developer control does not preclude individual unit owner suits, it does prevent unit owners from levying a special assessment to fund a litigation war chest.

- *Maintaining access to the common areas and sales offices.* Rightly or wrongly, developers often believe that if unit owners are given control of the association, they may, out of spite, seek to bar potential buyers from the premises or deny access to recreation amenities.
- *Preventing amendment of the governing documents.* During the period of active sales, the last thing a developer needs is for a unit-owner-controlled association to amend the governing documents in a manner that may be detrimental to sales. Examples include restrictions on investor ownership, prohibitions against pets, occupancy limitations, and prohibitions against leasing.

Avoiding Pitfalls During the Period of Developer Control

Developers concerned with post-transition claims of mismanagement or

breach of their fiduciary duty to unit owners can significantly reduce their exposure by treating the association from the inception of the development as a separate and unrelated entity and not as an arm of the developer. This can be accomplished

- establishing association bank accounts,
- segregating reserve funds and any capital start-up funds from operating revenues,
- using developer employee and association employees, for punch-lists,
- paying assessments on developer-owned units and/or ensuring a fall of guaranteed budget debt to the association (developers should never transfer unit owners' assessments to the developer entity while that entity is paying the bills—the association should pay its own obligations),
- engaging independent management,
- engaging independent legal counsel for the association,
- enforcing the covenants, restrictions, and the rules and regulations in a timely and proper form fashion,
- implementing a uniform collection program, applied equally to nondeveloper and developer-owned units,
- monitoring and controlling activities of the sales department,
- preparing a realistic operating budget,
- tying warranties of contract and subcontractors into warranties provided to unit owners and having them run concurrently,
- implementing a claims avoidance program by preserving evidence, addressing problems immediately upon notice, and following the code and the approved drawings and specifications, and
- establishing and maintaining communications with the unit owners (including responding promptly and courteously to individual punch list items).

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publishing newsletters, holding open board meetings, encouraging unit owners to serve, when appropriate, on the board and/or committees, and sponsoring social functions).

Pre-Transition Planning

Transition is not so much an event as it is a process. It begins with the closing of the first unit and continues until the unit owners, other than the developer, have the right to elect a majority of the board. Because the association is the unit owners' association from inception, notwithstanding the fact that its initial board is developer-designated, unit owners should be allowed to participate in the day-to-day operation of the association, to the extent permitted by the developer, so as to gain an understanding of its operation.

Most state laws afford the unit owners full access to the association's records from the inception of the association. Unit owners should use this access as an opportunity to review and become familiar with the budget, contracts for maintenance and operation, and day-to-day operations.

The period immediately before transition is a good time for the unit owners to become acquainted with each other. Social gatherings and town hall meetings provide a forum for identifying qualified candidates for the board and airing concerns. Often, an ad hoc committee of unit owners is formed for the purpose of formalizing communication between the developer and unit owners in planning for transfer of control. Among the ad hoc committee's tasks will be to identify an engineering firm for post-transition building inspections, an accounting firm to examine the books and records to ensure that the budget is accurate and that association expenditures are for association purposes, and a law firm to advise the unit owners about their rights and obligations.

Effecting Transition

Calling the transition meeting is the responsibility of the developer-controlled board, although some state

statutes authorize the unit owners to do so if the developer fails to call a timely meeting. Generally, the meeting notice will announce that the purpose of the meeting is to transfer control of the association from the developer to the unit owners. It will specify the date, time, and place of the meeting and the number of directors to be elected. Depending upon the governing documents or state law, or both, candidates may need to pre-qualify. For example, a candidate may need to be a record titleholder and not a convicted felon or must reside in a

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particular building or neighborhood. Some documents or statutes require the use of pre-printed ballots, listing all nominees; others provide for nomination and election at the meeting. In any event, pre-planning, including the compilation of a current roster of the units, unit owners, and voting representatives, will ensure a smooth transition meeting.

Upon receiving the transition notice some unit owners will balk at the notion that the unit owners should take control of the association, suggesting instead that transition be delayed until all developer obligations have been fulfilled. An informed ad hoc committee of unit owners will be able to allay concerns by explaining that transition and waiver of rights are not synonymous. The unit-owner-controlled association will have plenty of opportunity and time following transition to deal with post-transition developer issues.

In addition to calling the transition meeting, the developer will be responsible for turning over control of the association's books and records and,

in some instances, for providing a post-transition audit of the association for the period of developer control.

The Post-Transition Unit-Owner-Controlled Association

The natural inclination of the initial unit-owner-controlled board is to set as its number one priority the resolution of pending disputes over the nature and extent of the promised amenities or building defects. Although these issues will have to be dealt with, the board's first priority is not the warranties, but rather gaining

control over the day-to-day operation of the community.

Immediately following transition, the board will convene in an organizational session to elect its officers. Among the board's first acts will be to choose the individuals authorized to sign checks, engage legal counsel, and engage an accountant. The board will then review all the contracts between the association and vendors providing maintenance and operational services. These contracts will include management (either by staff or an independent management company), pool maintenance, elevator service, landscaping, insurance, security, and bulk cable. Depending upon the language of the contracts or state law, or both, the board may be able to cancel its contracts or renegotiate them.

The board should also prepare a census, identifying everyone living within the community, including pets and vehicles. The information should be compared against the roster of record title ownership, and, when the residents differ from the owners, the association should determine if those

occupying the units are guests or lessees. The census is particularly necessary if a community seeks to qualify as a "community for older persons" and thus be exempt from the familial status protection afforded to children living with a parent or guardian under the Housing for Older Persons Act of 1995. See 42 U.S.C. § 3607 (Supp. IV 1998).

The accounting inquiry will focus on whether assessments collected during the period of developer control were used solely for proper association expenditures.

A survey should also be conducted to verify that all structures are in compliance with the applicable covenants, conditions, and restrictions. If the structures are not in compliance, the board must decide whether to take enforcement action. Of course, in making this decision, the board will need to consider whether the association has acted and is acting in a timely and uniform manner. Equally important is the determination of whether all unit owners are current in their assessment obligations; if not, the board needs to implement a collection program.

Another consideration for the initial board is whether it is desirable to involve more unit owners in the affairs of the association by creating standing committees to deal with questions such as revising the governing documents or recommending rules and regulations necessary to control the use of the amenities. Other committees might deal with

- maintenance (grounds),
- architectural review,
- screening (for new buyers or lessees),
- communications/newsletter,
- social and welcoming activities,
- security, and
- the web site.

In a homeowners' association, there

may be a need to verify that association property or common areas were conveyed free of liens or other encumbrances. In a condominium, given the fact that the common elements are conveyed with the unit(s), there is generally no need to examine title, unless the association operates multiple condominiums or operates nondeclared amenities, or both.

The new board must also finalize arrangements for an independent engineer to inspect the property to ensure that its construction is in accordance with the approved plans and specifications, building codes, and general workmanship. As noted by one Florida appellate court:

This case . . . points up the necessity that condominium associations, as soon as the unit owners take over control, engage professional engineers or architects to determine whether the buyers received all that they thought they had bought. The likelihood is remote that volunteer unit-owner directors, however well-meaning, can ascertain as well as trained experts can whether the development buildings have structural integrity.

See *Conquistador Condo. VIII Ass'n, Inc., v. Conquistador Corp.*, 500 So. 2d 346 (Fla. Dist. Ct. App. 1987) (Glickstein, J., concurring).

Resolution of Disputes with the Developer

Post-transition disputes with the developer generally will involve questions of warranties, adequacy and completeness of the promised amenities, and accounting for association

funds during the period of developer control. Warranties are self-evident. Either the structures are properly constructed or they are not. The adequacy or completeness of the amenities is more difficult to ascertain because what one buyer may have read or heard may be totally different from that of another buyer. It is largely for that reason that many states deny a cause of action standing for what amounts to fraud or misrepresentation. Nevertheless, it is recommended that copies of all sales brochures, newspaper advertisements, state filings, and other materials be examined for representations of the promised amenities, such as a statement that the clubhouse will include an "olympic size pool." A simple check of the completed amenities will reveal whether what has been represented was in fact delivered. If not, missing items should be packaged with the alleged construction defects and accounting claims to fashion a comprehensive settlement.

The accounting inquiry will focus on whether assessments collected during the period of developer control were used solely for proper association expenditures. For example, was the individual employed by the developer to respond to the closing punch list compensated by the developer or the association? Particularly important to determine is whether the developer guaranteed the level of assessments and, if so, whether it funded any deficits. Often the sales contract provides for the collection from the buyer of one or two months of assessments to fund a "capital start-up fund." These funds should be turned over intact to the association at the time of transit

Conclusion

Although the transition from developer to homeowner control of an association involves sometimes conflicting interests, proper planning, information, and interaction between the unit owners and the developer during the transition process should ensure a smooth transition of the association's control and long-term viability of the common ownership housing development. ■