



Transition to Homeowner Control: Avoiding Problems and Finding Solutions

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INTRODUCTION

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Transition of the Association to Owner Control

1. Generally. Before CCIOA, "transition" from declarant control to owner control was a haphazard, informal and an ongoing process. CCIOA requires the declarant to gradually turn over control of the association as Units are sold or time expires.
2. Officers. At all times, the Executive Board elects the officers.
3. Election of Initial Owner/Board Members. Under CCIOA, three special meetings are anticipated during the declarant control period. More meetings may be advisable and fewer may be possible, but fewer meetings are not recommended. Preparations and planning for these special meetings should begin before the first sale and then be implemented through the declarant and/or management of the association.

The first meeting is to occur not later than 60 days after the conveyance of 1/4 of the "units that may be created" to owners other than the declarant. At that time, at least one member, but not less than 1/4 of the members of the Executive Board, must be elected by owners other than the declarant.

The second meeting is to be held not later than 60 days after the conveyance of 1/2 of the "units that may be created" to owners other than the declarant. At this meeting, not less than 1/3 of the members of the Executive Board must be elected by owners other than the declarant.

The third meeting is to be held not later than the termination of the period of declarant control. At that meeting, owners are to elect an Executive Board of at least three members, a majority of whom must be owners other than the declarant.

Beyond these three meetings, more meetings of the members are observed during the declarant control period, up to and even after transition. Transition occurs much more smoothly with communication between the declarant control association and the owners.

4. Outside Limits on Declarant Control in Most New Communities. Declarant control period in other communities terminates 60 days after the earliest to occur of the following events:
 - a. 75% of the "units that may be created" have been conveyed to owners;
 - b. Two years after the last conveyance of a unit by the declarant in the ordinary course of business (i.e. sales coming to a stop for a two-year period); or
 - c. Two years after any declarant right to add new units was last exercised.

Within 60 days after the earliest of one of these events to occur, the third meeting must be held, certain records must be turned over to the Association, and an audit of the association performed.

In communities which are exempt from CCIOA, transition is dependent on the provisions of the governing documents for the Community. Review the governing documents to determine the time frame and process for transition.

5. Outside Limits on Declarant Control in Large Planned Communities. In new large planned communities (those started after July 1, 1994; with at least 200 acres; zoning for at least 500 units and zoning for at least 20,000 square feet of commercial use space), the declarant may maintain control until earlier of 60 days after any one of the following events: Sale of 75% of the maximum number of units that may be created under zoning or development approvals; The lapse of six years after a conveyance by the declarant in the

ordinary course of business; or 20 years after recordation of the declaration. Within 60 days after one of these events, a meeting of the members must be held (to elect a board a majority of which are owners), records must be delivered, and an audit must be provided to the association.

6. Declarant Surrender of Control. In communities subject to CCIOA (and in communities exempt from CCIOA), the declarant may voluntarily surrender the right of appointment and removal of the Executive Board members before the termination of the declarant control period. CCIOA provides that the declarant may require for the duration of the period of the declarant control period that certain actions of the Executive Board, which the declarant has previously set forth in a recorded instrument, be approved by the declarant before they become effective. This veto right of a declarant is sometimes retained in the area of Design Review or architectural control, assessments, budgets etc. CCIOA gives the declarant this power to veto certain actions of the Executive Board as long as the veto is executed properly.
7. Turnover of Documents. In communities subject to CCIOA, within 60 days after the end of declarant control, CCIOA also requires the declarant turn over miscellaneous documents, records and an audit of the association. The items to be turned over include the following:
 - a. the original or certified copy of the recorded Declaration, as amended and/or supplemented;
 - b. the association's Articles of Incorporation, Bylaws, Minute Book, other books, records and all Rules and Regulations that may have been promulgated;
 - c. an accounting of association funds and financial statements from the date the association commenced receiving funds and ending on the date on which the declarant control period ends (the "Transition Audit");
 - d. the association's funds or the control thereof;
 - e. all of the tangible personal property of the owners and the association held or controlled by the declarant;
 - f. copies of the plans and specifications used in the construction of the improvements in the Common Elements;
 - g. all insurance policies currently in effect;
 - h. copies of all certificates of occupancy that may have been issued for common element improvements;
 - i. all other governmental permits;
 - j. all warranties of contractors, subcontractors, suppliers and manufacturers that are still in effect;
 - k. a roster of the owners and their mortgagees, together with addresses and telephone numbers;
 - l. employment contracts and service contracts in which the association is the contracting party.

The declarant also typically furnishes the association with the following to complete transition:

- a. all documents needed to support any special meetings of the association held to elect members of the Executive Board (to include notice, proxy, certificate of mailing, control list of the members, attendance records, together with the ballots);
- b. the resignations of the declarant's appointed members of the Executive Board and officers;
- c. certificate of Good Standing for the association from the Secretary of State dated just prior to transition;
- d. signature cards for all association bank accounts and appropriate banking resolutions;
- e. prior and current budgets;

- f. prior year's income tax returns (Colorado and federal);
 - g. tax ID numbers;
 - h. change of address cards for the billing of all services rendered to the association (trash, utilities, etc.).
 - i. evidence of compliance with Fair Housing Act accessibility requirements.
8. **Transition Audit.** A Transition Audit must be performed by an independent CPA and the delivery of the audit must be accompanied by a letter from the CPA expressing the CPA's opinion that the association's financial statements fairly reflect the financial position of the association in conformity with general accepted accounting principles; or a disclaimer of the CPA's ability to attest to the fairness of the presentation of the financial information in conformity with general accepted accounting principles and the reasons therefor. CCIOA states that the expense of the Transition Audit shall not be paid for or charged to the association. Depending upon the length of the time the Community takes to sell out, this audit could be expensive. If sales are not completed within a year or two, it is advisable to then perform annual audits, while the association is controlled by the declarant.
9. **Owner Participation During Declarant Control.** Having one or more owners on the Board of Directors prior to the time that the owners obtain control of the Board is only one manner of involving owners in the governance of the project. At all times, participation of owners should be provided for and encouraged by the declarant as another step in training and educating the owners to take over the operational responsibilities of the association.
10. **Ad Hoc Committees.** During the period of declarant control of an association, owner committees, to assist the Executive Board in making decisions, facilitate a smooth transition. Owners can be placed on various committees of the association. These committees can have responsibility for architectural control, maintenance of the common property and preparation of budgets, monitoring of the financial status of the association, etc. This can assist in creating a better environment for the relationship between the declarant and the owners. Often Communities are developed with owners feeling the declarant, developer or builder acts only in their own interests. A declarant, developer or builder may even give the impression to owners that they cannot wait to get out of the association and to transfer all association responsibility to the owner elected Board. This can create hard feelings, ill will and potential lawsuits. By involving owners in the Community early on, a feeling of confidence and team work may evolve. This would give owners the opportunity to learn about their Community before turnover to their control, so there will be some experience in the Community at that time. Committees also help assure future success of the Community. Declarants sometimes desire to maintain control of the association for as long a period as they can, particularly if they plan or expect any changes in the final stages of the development or the final sales of units. Yet, if everything is going well, declarants often consider releasing control earlier. In any event, having owner involvement through an ad hoc committee of owners or other means can be a tremendous benefit to the declarant, the owners and the association.
11. **Process.** In situations where the CCIOA transition process does not apply, the governing documents for some associations will provide for a gradual phasing in of owners on the Board of Directors. Even where such a process is not mandated by statute or the governing documents of the project, such a procedure is advisable in almost every community association.
12. **Misinformation - - A Cause of Transition Problems.** The declarant can limit the potential for problems with the association once the owners have obtained control of the Board of Directors if the declarant communicates effectively with the owners prior to that time. One thing the declarant can communicate to owners about is the manner in which the association is being operated for owner benefit. One of the biggest causes of problems for the declarant is misinformation which leads to unfounded rumors concerning the

governance of the association being circulated among the owners. Misinformation may lead to distrust of the declarant and a belief by the owners that the declarant is attempting to hide something from them or to control the association solely for the declarant's benefit and not for the owners benefit.

13. Looking Forward vs. Backward. If the owners have been involved in the governance of the association from the beginning of the project, they are less likely in many instances to delve deeply into the past operations of the association once they have obtained control of the Board of Directors. Without involvement of the owners early in transition, owners often look into past acts of the association to determine whether the declarant did something illegal or improper during the time the declarant controlled the Board of Directors.
14. Transition as a Process Rather than an Event. Transition is viewed by some as one event, that event being the meeting of the members at which control of the board is transferred from the declarant to the owners. Others view transition as a process beginning with the first closing, continue through the election of owners to the board and continuing on with regard to the operation of the Association. Transition should be a process which occurs over a period of time during which the owners gradually become more involved in the governance of the Community. Transition involves many components, including:
 - a. the transfer of control of the Board of Directors to the owners;
 - b. the transfer of control of the financial operation of the community association;
 - c. acceptance of responsibility for the maintenance of any common properties still maintained by the declarant; and
 - d. the turnover of documents.
15. Actions to be Considered/Taken by the Owner Controlled Board of Directors.
 - a. Retention/Selection of Managing Agent. One of the first actions of the new owner controlled Board of Directors should be to make a decision on the managing agent for the association, if the association is to be professionally managed. As with others retained by the declarant controlled Board of Directors, the new Board of Directors should consider any current managing agent and the relationship of that managing agent to the declarant in determining whether the management agent should be retained or a new managing agent hired. Managing agents who are actively involved can be very helpful in achieving a successful transition. They can play an extremely constructive role in transition by giving the unit owner Board of Directors perspective as to the dynamics of transition, the importance of communication, and the pitfalls of litigation. Too often, the manager takes too passive of a role.
 - b. Retention/Selection of Attorney and Accountant.
 - i. The new owner controlled Board of Directors should make a decision on the attorney and the accountant to represent the association in the future.
 - ii. In some instances, the declarant's attorney may also have been engaged as the association's attorney during the declarant control period. That counsel may be appropriate to retain if they are viewed as qualified, and available for matters unrelated to disputes with the declarant. For any disputes the association may have with the declarant, new independent counsel will be needed. In any event, if the new Board of Directors wants

to make a change, the existing attorney and accountant for the association should be given consideration.

- iii. In many instances, the declarant, during the time the declarant controlled the Board of Directors, will not have retained legal counsel or an accountant for the association. In those instances, the Board of Directors needs to move promptly to hire counsel and a new accountant for the association.
- c. Review of Financial Information.
- i. The owner controlled board should consider having the accountant for the association review the transition audit provided by the declarant and all financial information of the association for the time during which the declarant controlled the Board of Directors.
 - ii. The accountant could then be instructed to determine whether the declarant has paid all assessments and other amounts required to have been paid by the declarant during the period of declarant control of the association.
 - iii. The accountant could also be instructed to determine whether the amounts budgeted during the period of declarant control were adequate to pay all of the common expenses of the association or whether the declarant kept the assessments artificially low to encourage sales.
 - iv. Finally, the accountant could be asked to advise the Board of Directors of any accounting irregularities found during the accountant's review of the financial records and to advise the Board as to whether the financial records are complete.
- d. Legal Document Review. The owner controlled board should consider requesting the association attorney review the governing documents of the association to determine whether there are any unusual provisions in the governing documents or any provisions which should be amended in order to avoid future problems.
- e. Association Records. The Board of Directors should determine if all records of the association have been obtained from the declarant.
- f. Review of Insurance. The owner controlled board should consider reviewing all of the insurance policies of the association through an insurance agent and other experts to determine whether the insurance policies in effect conform to the governing documents of the project and to otherwise make sure that the association has adequate insurance coverage. Particular attention should be paid to Directors and Officers (D & O) insurance. Community association insurance is unique and changes should be approached cautiously. Changing insurance agents or carriers when control of the Board of Directors vests in the owners is not necessarily appropriate; however, a review of insurance coverage is encouraged. The review of coverage, rates and quality of service should be a periodic and ongoing process which is independent of the identity of the Board members, especially in the uncertain market places that exist today. Insurance should not be treated as political patronage, especially if the existing agent is providing good service and is knowledgeable.
- g. Reserve Study. The Board of Directors should consider engaging an expert to prepare a reserve study to determine whether the declarant controlled Board of

Directors budgeted for and funded adequate reserves for the repair and replacement of the common elements of the project or if the association desires to change reserve funding.

- h. Conveyance of Common Areas. If the project is a planned community, the Board of Directors should confirm that all common areas have been conveyed to the association by the declarant in accordance with the governing documents of the project and any applicable state law. The Board of Directors should consider obtaining title insurance for the common areas conveyed to the association.
 - i. Review of Prior Enforcement Actions. The Board of Directors should review all enforcement actions taken by the declarant controlled Board of Directors or any violations which the declarant controlled Board of Directors failed to enforce to determine whether any enforcement actions need to be filed by the association and to evaluate whether particular types of violations may have been waived through non-enforcement of the restrictions by the declarant controlled Board of Directors.
 - j. Review of Building Plans. Multi-family buildings which were designed and constructed after March 13, 1991 must meet federal requirements regarding handicap accessibility. The Board should consider having an architect and/or engineer review the building plans, and the actual buildings for compliance with the Fair Housing Amendments Act (FHAA) accessibility requirements.
16. Construction Defect-Related Transition Issues.
- a. Transfer common property before control of the Board passes to the Unit Owners. It is a mistake for both the developer and the owners to postpone the transfer and/or acceptance of the common property to the Association until after seventy-five percent of the units have been sold and the owners assume control of the governing Board, especially where there is a significant time lapse due either to the size of the project or the slow rate of sales. We prefer to see the developer controlled Board of Directors under these circumstances permit the minority unit owner members to select an independent engineer, at the expense of the Association, to inspect the completed portions of the common property and to negotiate the extent of the remedial work with the developer, subject to an express written agreement that there is no waiver of any legal rights by either the Association or the developer pending turnover of control of the Board of Directors to the owners. Although this approach may not be feasible in every circumstance, it encourages the separation of construction defects from maintenance problems and helps to isolate the responsibility for each type of problem. It also eases problems of proof for both sides should formal proceedings ultimately be instituted and encourages cooperative rather than adversarial solutions with respect to the physical problems which may exist. Most importantly, the developer can look to its subcontractors to remedy defects while they are still on the job and monies have been retained under their contracts.
 - b. Physical Inspections and Engineering Reports.
 - i. The association should consider engaging an expert or an engineer to review the plans and specifications for the project and make a physical inspection of the project to determine whether the plans and specifications were followed in the construction of the project, whether any construction defects exist through poor workmanship or defective materials, and whether the project was constructed in compliance with the Fair Housing Act's accessibility requirements. The following areas of the project should be included in such inspection:

- Site grading and drainage;
 - Stormwater system and components (including detention and retention facilities);
 - Concrete slabs on grade (i.e. sidewalks, patios, dumpster pads, etc.);
 - Pavement installations (i.e. roadways, driveways, parking areas, etc.);
 - All exterior roof elements (i.e. chimney chases, exposed flues, vents, gutters, leaders, shingle installation, etc.);
 - Foundations (utility penetrations, wall condition, adjacent grading, etc.);
 - Stoops, decks, and balconies (including railings, structural support and connections, attachments, and stability, etc.);
 - Common area landscaping (plantings should be inspected for size, type, location, and health);
 - Lighting (fixtures should be inspected for size, type, location, installation, and coverage);
 - Building waterproofing and exterior finish materials (stucco, EIFS, and/or siding);
 - Retaining walls;
 - Fences, decorative entrance structures, gazebos, stone or concrete paved walks, and other miscellaneous site structures;
 - Interior inspections (including interior of roof system, structural components of the unit, insulation, foundation walls and slabs in basements, and any signs of settlement);
 - Recreational facilities (including all amenities, furnishings, appliances, etc.);
- ii. The Board of Directors should consider obtaining a written report from the engineer and should then determine, in consultation with the association's legal counsel, whether any claims should be made against the declarant for any construction defects which are found to exist in the project.
- iii. Engineering reports are not intended to be primarily for litigation purposes. The primary purpose of an engineering report commissioned by an association is to obtain professional assurance for the Board that the physical condition of the property is satisfactory and to identify deficiencies which need to be addressed. Its main object is to discharge the Board's fiduciary duty to ascertain the physical condition of the property before it is accepted for maintenance and not to serve as a spring board for settlement negotiations or litigation against the developer. Therefore, given this perspective, a clean report by a qualified engineer is the best result for both sides.
- iv. Canned engineering reports may do more harm than good in transition negotiations. Canned engineering reports, as well as those which are overly judgmental, tend to raise questions about their technical credibility. A report which is more individually tailored and factual is normally better because the other side will address it more seriously. Also, the separation of maintenance problems from construction problems is important. To homogenize them in the same report can foster the notion that most of the problems are maintenance related, which is not always the case. Also, the engineering report should not contain either absurd or peripheral

items for they only detract from the importance of the significant issues and impact negatively upon the credibility of the entire report. Also, this type of report tends to result in both parties getting hung up in the detail. Try to cull out these items before submitting a report to the other side and focus on the important items. The others usually disappear anyway, if and when the primary issues are resolved.

- v. Don't be too quick to give a formal engineering report to the other side. Engineering reports can be trouble for either side if they are not judiciously prepared and reviewed by counsel before being finalized. Nothing can destroy the credibility of a report more completely than obvious mistakes engendered by carelessness, boiler plate language, stretching of the facts, or inadequate homework. In addition, a report which is too candid or says too much can prejudice one's client in the fact of any litigation. Consideration should be given to having the engineers for each side prepare summary reports which cover the major defects, although notes can be made and maintained by the engineer. The summary report can be used as a basis for initial discussions to see if basic agreement can be reached on the major issues between the clients and their technical consultants. Otherwise, too many details may stand in the way of reaching agreement on the important issues.
- c. Use of experts.
 - i. Experience in transitions and in court is an absolute must when choosing a law firm and experts for the transition. In choosing a professional consultant in connection with a transition negotiation, try to obtain assurance from your attorney that the consultant's report and his individual testimony will stand up in court. An experienced adversary will know or quickly learn about the weaknesses of each and exploit them during the settlement negotiations, as well as the time of trial, just as he will in the case of a law firm which does not have experience in construction defect or community association transition and litigation. Be on guard against penny wise and pound foolish in this area for it is clearly more expensive to have to hire a second professional if the first turns out to be inadequate, not to mention the prejudice that may have occurred to your case as a result of the wrong initial choice.
 - ii. Informal communications between professional consultants can be effective and economical. Consider having the engineers and the accountants for both sides talk to each other early in the transition process. If they are professional in their approach, it should enhance communications, eliminate spurious claims and minimize professional fees for both sides. Attorneys by nature tend to be adversarial and therefore communications through attorneys do not necessarily promote constructive dialogue. It is a good idea however, to have a written understanding between the attorneys as to the ground rules and the fact that none of the discussions between the other professionals can be utilized in any subsequent litigation.
- d. Punch lists from unit owners impede successful transition negotiations. The compilation of a unit owner punch list, especially with respect to individual units, is a deterrent to a successful transition negotiation because it unduly raises the expectation level of the individual unit owners. Therefore, it is more difficult politically for the Board of Directors to reach a fair and reasonable settlement with the developer. Furthermore, an association is not empowered to settle unit claims

and the unit owners should not be led to believe otherwise when it is clear that any knowledgeable developer will reject unit claims as a matter of course. As for an alternative to a punch list, a questionnaire prepared by the engineer related to specific physical aspects of the common elements may be a useful tool in helping the engineer identify the construction problems with may exist, but care should be exercised to make certain that its purpose is not misunderstood.

- e. Don't indiscriminately sue developers personally. Combative instincts of attorneys tend to encourage the inclusion of the principals and/or the officers and directors of the developer as a defendant in community association litigation even when their potential liability appears to be highly speculative or nonexistent. Suing them personally should not be a reflex action because if there is either the hope or potential for future settlement dialogue, nothing can cause a developer to stonewall an association more quickly than to make him an individual defendant. Accordingly, the potential for settlement may be diminished significantly, if not extinguished altogether, and instead, the association may be faced with the aggravation and expense of years of litigation.

17. Summary Questions for the Board to Consider.

- a. Have you reviewed the legal sufficiency of the governing documents?
- b. Have you reviewed the insurance policy to determine whether there is sufficient coverage and whether coverage is consistent with requirements of governing documents and statutes?
- c. Have you reviewed the budget line items to determine whether adjustments are necessary (amounts as well as line items)?
- d. Have you obtained/reviewed a reserve study to determine whether it meets the needs of the community?
- e. Have you inspected the common areas before "accepting" them from the declarant (if appropriate)?
- f. Have you engaged an expert to review the plans and specifications for the project and make a physical inspection of the project to determine whether the plans and specifications were followed in the construction of the project, and whether any construction defects exist through poor workmanship or defective materials?
- g. Do you have deeds for all common areas conveying ownership to the association?
- h. Have you reviewed all enforcement actions taken by the declarant or any violations which the declarant failed to enforce to determine whether any enforcement actions need to be filed by the association?
- i. Have you reviewed your condominium buildings for compliance with the Fair Housing Amendments Act (FHAA) accessibility requirements?
- j. Have board members been provided with copies of all contracts, governing documents, contact information, budget, reserve, etc.?
- k. Have board members received an "orientation" to the operation of the community and their fiduciary responsibilities?
- l. Do you understand the relationships/interplay between the association and the districts and sub/master associations, if any?
- m. Do you have contact information for any master or sub associations and/or special districts?
- n. Do you have copies of marketing materials used by the developer and/or builder in selling homes within the community?

18. Communication is the Key to Successful Transition. The key to a successful transition from declarant to owner control of a community association is communication between the declarant and the owners. Communication with the owners should begin with the sale of

the first closing. The goal of the communication with the owners should be to educate the owners about the role and operation of the association and to establish trust between the declarant and the owners.