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DEVELOPER TRANSITION:

HOW COMMUNITY ASSOCIATIONS ASSUME INDEPENDENCE

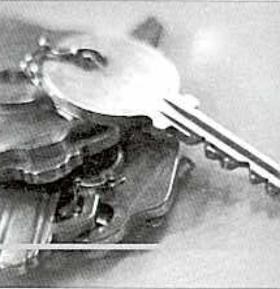
By Amanda G. Hyatt



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Developer Transition: How Community Associations Assume Independence
Fourth Edition

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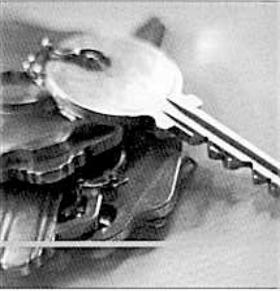
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INTRODUCTION:

BACKGROUND AND KEY POINTS



TRANSITION FROM DEVELOPER TO OWNER CONTROL IN A condominium or master-planned community is one of the most critical phases in a community's growth. If conducted properly, it will give the association the independence it needs to mature into a capable governing body. This guide will help both developers and owners enjoy the benefits of a successful transition and avoid the legal and moral pitfalls of an improperly conducted transition.

KEY POINTS

- Transition from developer control occurs when control of the association shifts from the developer to the owners. Transition evolves from the time most units are sold and conveyed to the owners.
- A smooth transition benefits both the developer and the owner. Cooperative efforts between both parties can result in a well-run association. A poorly planned transition with uncooperative developer-owner relations can result in angry unit owners, lawsuits, a bad reputation for the developer, and an ineffective association.
- The developer should strive for early and continuing owner involvement and education in association operations.
- The developer and the owners must recognize their mutual interests and cooperate and communicate with each other during the transition period.
- An interim set of committees—staffed primarily by owners—facilitates transition work and provides training for future leaders and ongoing committees.
- The transfer of control can occur in several ways:
 1. Addition of one or more non-developer unit owners to the board of directors at specified levels of sales.
 2. A weighted voting approach, in which the membership voting ratio is arranged so that the developer will relinquish control of the association after a specific

percentage of the homes have been sold.

3. Use of an interim committee or advisory board to make most association-related decisions. Transfer of substantial control to owners. The developer retains veto rights for certain actions that would result in a basic change in the character of the development or that would adversely affect project marketing.

4. A combination of two or more of these methods.

- In the absence of an effective developer-initiated transition process, it may be necessary for the owners to assume responsibility for developing effective leaders.

CHAPTER ONE: METHODS OF TRANSFER



AN ASSOCIATION'S SUCCESS OFTEN DEPENDS ON HOW GOVERNANCE is transferred from developer to owners. Ideally, owners should gradually become involved in the association's operations and decisions. However, owners and developers often are reluctant to undertake the transition process. The developer may fear that owners will interfere with building and marketing, thus threatening profitability. Owners may be reluctant to accept responsibility for the association for fear of assuming a financial or legal burden. By understanding the process and the benefits of a successful transition, each party will be more comfortable working with the other.

One way to understand transition is to understand what it is not. For instance, transition is not the act of transfer or acceptance of the common elements or common property.

In condominium developments, for instance, the common property is subject to the condominium regime when the condominium is created, so the property is already "turned over" to the unit owners when they purchase their units. In home-owner associations, the common property frequently is deeded to the association prior to the sale of the first units or during early stages of a multiphase development.

Transition also is not the turnover of the common elements to owners who then have no further recourse for construction defects in the common elements. Furthermore, transfer of control from the developer to the owners does not necessarily ensure that developer construction warranties have been met.

Transition is a process—a series of events—that transfers control of the association from the developer to the individual unit owners. In a well-planned and implemented transition program, actual turnover is a mere formality that marks one event during an extended process when the developer relinquishes control of the association.

WORKING TOGETHER

Experience shows that a well-planned transition, which combines thorough owner-education with the gradual transfer of control, will result in a well-run association. By working together during the transition period, the developer and the unit owners can understand the concerns of each party and protect their interests.

Both parties benefit from a successful transition and early owner involvement. The developer benefits by gaining a good reputation. And owners learn about every facet of association operations. This knowledge enables them to manage the association effectively, matching community needs with the association's financial capabilities. The result is a successful community association, a credit to the developer and a sound investment for the unit owners.

It is important to realize that the level of owner involvement varies depending on the association's character. For example, an owner-occupied residential development can expect a much higher level of participation than a second-home resort development. Also, the complexity of association operations and the size of the common elements can affect involvement. A development that features a large recreational package and exterior building maintenance will involve more owners than one with limited common areas.

Successful transition requires advance planning. Preparation for transition begins with the initial planning of the project and carries through until unit owners are in complete control of the association. It involves all phases of the development process. Though the process may be time consuming, eventually it will return dividends to all involved.

IDEAL TRANSITION SCENARIO

Ideally, the development of a community association begins when the developer meets with those involved in planning the development—attorneys, architects, lenders, accountants, and marketing and management consultants. These professionals should discuss:

- Details of the physical development.
- Financing and marketing plan for the project.
- The association's structure.
- Programs to facilitate involvement and education.
- A timetable for the shift of association control to the unit owners.

After the planning is completed and the physical development is underway, the developer's attorney drafts the legal documents. While it is necessary for an attorney

to draft the documents from a legal point of view, a management practitioner should review them from an operational point of view. The development team also should draft a comprehensive maintenance manual to provide a reliable guide for the association—regardless of who controls the board.

Education of new owners begins with materials and explanations provided during the sales process and with a new owner orientation program given shortly after conveyance. This material should include:

- Explanations of the community association concept.
- Particular aspects of the documents and rules and regulations.
- A description of the association's operation and management.
- The stages of transition from developer to owner control (See Figure 1).

The developer identifies activities in which the owners can become immediately involved and solicits participation in these activities. As owners increase in number, the developer or its representative should hold periodic meetings to discuss development progress and association operations. The meetings also should solicit owner input.

The developer should encourage owners to participate in the maintenance, insurance, orientation, communications, architectural review, and finance committees. Their recommendations should have increasing weight in the board's deliberations. When the number of units sold reaches a pre-designated percentage, owners should begin having a more formal involvement in the association's governance. At this stage, the owners elect representatives to serve on an interim committee, an advisory board, or the board of directors, with the percentage and form of representation depending on state statute, association documents, and/or the developer's stated transition plan. These owner representatives would then have the opportunity to present unit owners' views to the developer-controlled board. As additional sales levels are achieved, unit owners are generally entitled to additional representation until, eventually, they hold a majority of the seats on the board. At this point, the owners have complete control of association decisions, unless the developer has retained a veto over certain board decisions until the development is largely complete. In this case, owners gain complete control when the developer's veto right expires.

In the ideal scenario, turnover is a formality. The developer helps phase-in owner responsibility and owners are already in charge of key committee functions when the developer leaves the community. Association operations do not skip a beat. Any disputes between the association and the developer over items such as common-area deficiencies still need to be addressed, but board members can represent owners'

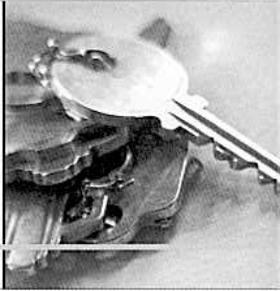
interests from the experience they gained during transition. Furthermore, many problems regarding assessment collection, contract awards, and maintenance quality are identified and handled earlier in the transition process.

Although the ideal scenario seems straightforward, the developer must undertake a carefully conceived, multifaceted plan to achieve it. The following chapter looks at the steps needed to develop a legal framework for transition.

FIGURE 1. THE STAGES OF TRANSITION

- Developer begins the transition process during the development's initial planning phase.
- The transition structure is in place before the first unit is sold.
- Unit owners become educated about association affairs as the transition process unfolds.
- By the time unit owners have actual control of the association, the committee structure and owner involvement have matured.

CHAPTER TWO: LEGAL FRAMEWORK



THE LEGAL FRAMEWORK FOR TRANSITION IS ONE OF THE MOST important parts of the transition process. If properly conceived and structured at the outset, this framework can speed the process along to a successful conclusion for both the developer and the homeowners. It also can help limit misunderstanding and court action between the parties. The legal framework for transition, especially for condominiums, typically is set forth in broad terms in state statutes. The statutes set minimum standards for the process. The developer must understand the nature and form of such requirements to provide appropriate language for the association's legal documents.

STATUTORY CONSIDERATIONS—CONDOMINIUMS

State legislation and regulation dealing with the community association process have focused predominately on condominiums. The first generation of condominium statutes enacted in the early 1960s were often basic enabling statutes, and they were typically silent on the transition of control. Over half of the states that enacted second-generation condominium statutes include provisions requiring the transfer to be based on the conveyance of a set percentage of units. They also require the transfer to occur no later than a set number of years following the sale of the initial unit.

While the developer is free to provide for earlier transfer, the statutes establish the outside limits as a protection for the unit purchasers. These provisions, however, also benefit the developer because the law establishes specific procedures that force the transition process to take place and the unit owners to assume control.

The Uniform Condominium Act (UCA) was developed by the National Conference of Commissioners on Uniform State Laws and endorsed by the American Bar

Association in 1977. By 1997, a number of states, including Maine, Missouri, Nebraska, New Hampshire, New Mexico, North Carolina, Pennsylvania, Rhode Island, Texas, Virginia, Washington, West Virginia, and the District of Columbia had adopted the UCA while such states as Arizona, Georgia, Louisiana, Michigan, and Wisconsin had adopted portions of it. The UCA contains specific language regarding transition. It requires unit owners (excluding the developer) to elect at least 25 percent of the board members following the conveyance of 25 percent of the units and at least one-third of the board following 50 percent conveyance. Developer control terminates following the conveyance of 75 percent of the units or at the end of a set number of years, whichever occurs first.

Other state statutes, e.g., Georgia, vary the percentage of undivided interests and the deadlines on developer control on expandable and non-expandable condominiums from those in the UCA.

STATUTORY CONSIDERATIONS—MASTER PLANNED ASSOCIATIONS

Subsequent to the UCA's development, the National Conference of Commissioners on Uniform State Laws developed the Uniform Planned Communities Act (UPCA). The Conference then developed the Uniform Common Interest Ownership Act (UCIOA) in 1982 that addressed both condominiums and planned communities. As of 2003, UCIOA had been adopted in its entirety by Alaska, Connecticut, Minnesota, Nevada, Vermont, and West Virginia.

UCIOA provides that the developer's right to appoint and remove board members ends when the first of the following occurs:

- Sixty days after conveyance of 75 percent of the units.
- Two years after all developers stop offering units for sale in the ordinary course of business.
- Two years after the developer's right to annex property was last exercised.

If the developer voluntarily relinquishes the right to appoint and remove board members earlier than the UCIOA requirement, it may retain the right to approve certain board actions during the remainder of the period specified for developer control.

The UCIOA provides a phasing-in process for relinquishing control of the board of directors. Unit owners must be permitted to elect at least one director or 25 percent of the board within 60 days after the sale of 25 percent of the total number of units. They must be permitted to elect one-third of the board within 60 days after the conveyance of 50 percent of the units.

OTHER CONSIDERATIONS

To date, few states have statutes dealing directly with the transfer of control in associations that are not a part of a condominium project. Florida enacted such legislation in 1992. The principal constraints placed on the developer in structuring the transition process occur due to lenders' requirements and federal lending-related agency guidelines. Typically, the lending-related requirements in a homeowner association seek to complete the transfer of control before 75 percent of the units are sold or within a minimum number of years following the first conveyance.

Certain states, most notably California, Florida, and New York, have real estate departments that oversee the creation and operation of community associations. Projects approved for Federal Housing Administration (FHA) and Veteran's Administration (VA) financing require owners to control the association once 75 percent of the units have been conveyed to owners. Documents suggested by HUD and VA contain the weighted vote concept.

It is clear, then, that in drafting the original legal documents for a condominium or master planned community, the developer must consider the effect of the following factors:

- Constraints of state statutes or regulatory bodies.
- Local governmental policy or practice.
- Requirements of federal lending related agencies.

DRAFTING THE LEGAL DOCUMENTS

While statutory and other factors may come into play, the developer has substantial latitude in setting forth the legal framework for transition when drafting the community association's legal documents. The developer should make a conscious determination in the planning process to balance its interests with those of the owners. This balance includes adequate protection for the owners and suitable flexibility for the developer. The legal documents should provide the procedures needed to accomplish this goal.

The documents should be flexible enough to adapt to changing market conditions. If the language provides a specific date for turnover—rather than a flexible guide based on sales levels—owners may gain complete control of the association when only a small percentage of the units have been sold. The developer always has the option to accelerate the transfer, if sales are progressing and if the owners are properly prepared to assume control. However, premature transfer of control to owners can cause severe problems.

On the other hand, the developer who actively controls the board is in a very

awkward position. When developer representatives sit as members on the community association's board, they have a fiduciary duty to take action that is in the association's best interest—even if the action is detrimental to the developer. Acting as a developer/board member requires a conscientious effort to avoid any real or apparent conflict of interest.

Why would a developer want to maintain such a difficult position? Primarily, the developer is concerned that the association is operated in a manner that maximizes the development's marketability. Unless the developer is confident that the owners can maintain the association and its property to that standard, it will be reluctant to release board control.

LEGAL TRANSFER OF CONTROL

There are five basic approaches for transferring control:

1. The addition of one or more owners to the board at specified levels of sales.
2. The use of an interim board, an advisory board, or committee, or a shadow board consisting of owner representatives who work with the developer-controlled board to make decisions.
3. The early transfer of full board control to the unit owners, with the developer retaining review and approval power over board actions.
4. The use of a weighted-voting approach in which the developer has a weighted vote for each unsold unit. The developer automatically loses control as units are sold and owner votes outnumber the weighted vote.
5. The use of a combination of these methods.

Specified Levels of Sales

This first approach—adding one or more owners to the board at specified levels of sales—is perhaps the most common method. This also is the approach taken in the UCA and the UCIOA. Although the actual percentages may be a topic of debate—whether the first owner/director should be elected at 25 percent or 33 percent, or whether final control should occur at 51 percent, 75 percent, or 80 percent—the idea behind the procedure is a sound one.

The speed with which owners are added to the board is tied directly to the sell-out pace. Direct involvement on the board by a non-developer-related unit owner at an early stage in the project's life is one of the best ways to assure unit owners of the developer's good faith and of the owners' ability to influence decisions affecting association operations.

The board must adhere to professional conduct, regardless of whose representatives control the majority votes. Thus, the developer-controlled board should conduct formal meetings, maintain meeting minutes, and, in all other ways, conduct the association's business as a business. The addition of non-developer board members should not affect the manner in which the board operates.

Advisory Board

An approach that can occur by default as well as by design, the advisory board, shadow board, ad hoc committee of unit owners, or interim board provides owners with a body of unit owner representatives who are elected by other owners or who emerged by consensus. This group represents the unit owners to the developer-controlled board.

Depending on whether the developer created it or it arose spontaneously, this body may make substantive recommendations to the developer-controlled board, or it may simply monitor board activities and association operations. Preferably, the advisory committee will act at the request of the board to investigate, evaluate, recommend, and, in many respects, run the day-to-day life of the association. The developer may encourage unit owners to elect their own members of the advisory board or it may allow committee chairs to act as the body of the advisory committee. It's important to differentiate between the roles of the board and the shadow board. Owners, especially those who are new to the community often are confused about who is in charge.

The developer also can use focus groups to gather owner input. This approach can result in broader-based owner involvement and assure participation beyond the recognized owner leaders. Additionally, focus groups can maintain open communication between the two groups.

Developers benefit from the advisory board approach because of its flexibility. It allows meaningful owner involvement without losing control or unnecessarily impeding the efficiency of board operations. How the advisory committee is established, how its numbers are chosen, and how much real authority it is given are all variables that can be modified to fit the characteristics of the individual development.

Unit owners may be concerned about how much they really affect association operations and how they will obtain full control. A developer can easily alienate owners by providing for advisory committees and then ignoring their recommendations. Adopting this approach brings an implied commitment to listen seriously to owner recommendations.

Retained Veto

The third approach—the retained veto—was originally developed when directors and officers liability insurance was not available to mixed boards (those that had both owner and developer representative directors). It allows the developer to turn over complete control of the board to non-developer unit owners. Early turnover enables the association to purchase insurance while protecting the developer’s ability to complete and market the project. It also allows the developer to review and veto board decisions, even after the board is elected by the owners.

The veto provision covers a wide range of issues, including changes to the scheme of development, changes to the basic architectural covenants and guidelines, or other matters that might unfairly impede efforts to complete and market the project. Developers using this approach have indicated that they have seldom, if ever, had an occasion to exercise the veto. Of course, the documents must establish a date or certain point in time to terminate the developer’s review authority.

From the developer’s perspective, the retained-veto approach has several advantages. First, as the owners take more responsibility for running the association, the developer can relinquish that control without endangering the basic developmental or sales effort because it can veto adverse board decisions. By moving off the board, the developer’s liability and exposure to lawsuits for conflict of interest or mismanagement are reduced. And the burden of running the association is removed from the developer’s shoulders and transferred to the owners, who typically have a greater interest in such matters.

For the owners, it allows for a much earlier transfer of control. And owners’ interests are protected by the fact that the developer has no greater power to initiate action than any other owner.

Weighted Vote

The fourth alternative—the weighted-vote approach—is frequently seen in master-planned communities. Originally promulgated in VA and HUD form documents, this approach is more a method of quantifying votes than a transition device. With this method, turnover is an event rather than a process. It does not provide for any phase-in of owner involvement. Developer-owned units are assigned a weighted vote, while the remaining units are each assigned a single vote. Once the total non-developer unit owner votes exceed the total developer-weighted votes, the owners assume control of the association and elect an owner-dominated board. For example, the developer-owned units may have three votes each. When 75 percent of all units are

sold, the developer’s weighted vote will then equal the owners’ total vote. At that point, the developer typically loses the weighted-vote advantage because each remaining unsold unit is assigned one separate vote. Owners are then in control and can elect their own board.

In most respects, this approach is simply a variation of the first alternative, but it is set forth through a more complex procedure with a rigid application. Control is still transferred following a fixed percentage of conveyances through an automatic procedure. Until that level is achieved, however, voting control cannot be shifted. The developer must voluntarily elect to cast votes for owners or rely on the interim board approach to affect earlier owner involvement.

Combined Approach

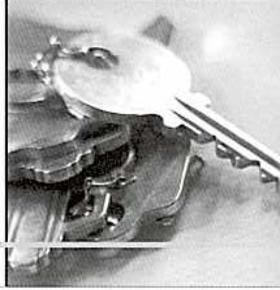
The fifth alternative combines these approaches. Most often, combinations occur when the developer finds it necessary to overcome inflexible documents or needs to facilitate greater and earlier owner involvement than what is presented in those documents.

At the beginning of the planning process and early development phase, the developer must carefully consider the transition approach that will be set forth in the legal documents. Each approach has advantages and disadvantages, depending upon the specific nature of the development and the transition the developer wants to achieve. Whatever approach or combination of approaches the developer selects, it should carefully consider the steps necessary to implement each approach, fully explain the process to the owners from the outset, and adhere to it as much as possible.

All associations have a “moment in time” when actual transfer of control occurs, but preparations for that moment should occur from the planning stages. The committee structure, described in Chapter 3, is the backbone for establishing the basis for preparedness.

CHAPTER THREE:

COMMITTEE STRUCTURE



THE NUMBER OF OWNERS AND COMMITTEES INVOLVED IN THE transition process increases over time. Two major efforts should be underway simultaneously: the operation of the association by the board (with or without developer-controlled members) and the training and education program for unit owners. At times, the two activities may be indistinguishable, but they should be separate functions operating along parallel tracks.

Figure 2 contains a sample committee structure for a single-phase association that uses a procedure similar to the one proposed by the UCA and the UCIOA. In the early period of sales, unit owners are involved primarily in the social aspects of the community and help new owners feel welcome. Although committee activity in more substantive areas may occur at this stage, it will not be very pronounced.

By the time half of the units are conveyed, however, the association should have established a fairly basic set of owner-dominated committees that answer to the board. At this time, the members should learn about the operations that directly concern their committee and review existing practices for future operations.

All committees should be functioning before the designated turnover percent of the units have been sold. The degree to which the developer is involved in committee functions depends on the method chosen for adding owners to the board. As long as the developer holds the majority of the board seats, it controls the committees through appointment power.

Regardless of what they are called, each committee should have a statement of responsibilities and purpose to guide its members. (See Figure 3.) Although the statement of purposes can be modified, clear goals will guide members. The following discussion examines each committee and discusses what the developer and the developer-controlled board should do to plan and initiate committee functions.

FIGURE 2. SAMPLE TRANSITION PROCESS FOR A SINGLE-PHASE COMMUNITY ASSOCIATION

Point of Closings	Committee Activity	Committee Control	Association Governance
Before 25 percent of closings	Orientation Communication	Developer controls, owners chair or staff	Developer controls all or most of the seats on the board (five to nine seats); the owners may elect one or two members
	Covenants & Enforcement Finance Insurance	Developer controls through board, owners, staff	
Before 50 percent of closings	Maintenance Orientation Communications Insurance	Developer controls, owners chair	Transition board with developer controlling majority, but additional owners/members may be elected
	Covenants & Enforcement Management Finance	Developer controls through board, owners, staff	
Before 75 percent of closings	Maintenance Orientation Communications Insurance	Owners' control	A transition board. Depending on the legal documents and statutes, the developer should shift to a minority position. The board calls a membership meeting to elect board members and to transfer control.
	Covenants & Enforcement Management Finance	Owners control with developer involved	
	Transition	Joint committee of developer and owners	
By completion of closings	Maintenance Orientation Communication Insurance Covenants & Enforcement Management Finance	Owners' control	Complete owner control of board

This structure follows the procedures suggested in the Uniform Condominium Act. Percentages can be adjusted, as can the nature and type of committees, to suit the size, location, and unique characteristics of specific associations. Adapted from *Creating a Community Association: The Developer's Role in Condominium and Homeowners Associations*, CAI and ULI, 1986 (revised).

FIGURE 3. MAJOR COMMITTEE TASKS DURING TRANSITION

Covenants, Rules, and Design Review Committee

- Review documents for covenant restrictions and authority for rules promulgation.
- Review existing policies, procedures, rules, and regulations for need, adequacy, and enforceability.
- Develop new standards where needed and revise accordingly.
- Develop method for regular dissemination of regulations and enforcement.
- Develop procedures for notice of violation, hearing, and appeal.

Finance Committee

- Review and monitor assessment collection and enforcement.
- Review budget and help develop new and revised budgets.
- Review financial records and establish regular financial procedures.
- Recommend action on any deficiencies.
- Assist in audit.

Insurance Committee

- Review documents to determine what coverage is required.
- Review existing coverage to determine if it is adequate and competitive.
- Investigate various ways to minimize risks and premiums.
- Inform owners of the association's coverage and coverage owners should carry.

Maintenance Committee

- Learn about the common elements and the association's maintenance responsibilities.
- Inspect all common elements and note deficient warranty items, common construction defects, potential hazards and claims, and maintenance items.
- Review all plats, plans, engineering drawings, warranties, bonds, and contracts that involve common elements and maintenance. Obtain permanent copies for association files.
- Delineate those items that are the association's maintenance responsibility and those that are the individual unit owner's responsibility. Provide that information to all owners.
- Develop procedure for letting maintenance contracts.
- Recommend action where indicated.

Management Committee

- Review all association files and management contracts.
- Investigate alternative methods of management.
- Review all contracts and contractor performance.
- Establish nomination and election procedures.

Transition Coordinating Committee

- Coordinate final phase of transition activities between unit owners and developer.

Communications Committee

- Provide new owner education/orientation program.
- Assure two-way communication conduit between owners and the board.

COMMUNICATION

Probably the most important element in any community association is effective communication between the board and the unit owners. A good communication system can forestall the development of cliques and factions and can help the association provide services that owners want. It also can help owners develop a sense of trust in the board members.

The developer, as part of the sales process, should design and implement a new-owner education program. It may use group closings, an owner orientation program, or a welcome committee—all of which are designed to educate and involve the owners from the outset. The developer may then use general association meetings, social events, the association's web site, and/or a newsletter to continue to develop a sense of community. Unit owners will be more cooperative during the development's marketing period if there is regular information disseminated about how construction and sales are going and what, if any, problems are encountered.

These same approaches to new owner education and involvement should be continued by an association committee, regardless of who is in control of the board. Information on the association's operations, actions, plans, and committee activities should be shared at all times.

The committee of unit owners involved with communications will probably be one of the first organized and may evolve into more specialized committees dealing with hospitality and welcome, communication (newsletter, block captains, cable shows, etc.) social activities, and recreation. In the early transition stages, however, the committee will provide a communications system to provide a two-way conduit for owners to receive information from and to transmit questions to the board. Additionally, it can develop, evaluate, or revise the welcome package for new owners, provide input for a newsletter or community electronic bulletin board, and sponsor social and recreational activities.

MAINTENANCE

The maintenance committee should learn about the common elements and the extent of the association's responsibilities by reviewing association documents and any maintenance manuals. It also should make a physical inspection of the property to identify any repairs that need to be made.

The committee must develop a complete inventory of everything that needs to be maintained. In some states, the builder must provide "as built" drawings, which help with inspection and maintenance activity. The maintenance inspection also enables

the committee to evaluate long-term replacement requirements for input into the budget process. The committee may want to use a qualified engineer to assist with this assessment and evaluation.

The maintenance committee should review the following items with the developer to help assess maintenance needs:

- All plats, plans, and engineering drawings for the common elements.
- All guarantees, warranties, and bonds provided by the developer.
- Any operational policies or schedules that the developer has formulated for maintaining the common elements, including any landscaping plan.

The developer should provide copies of these materials and include them in the association's permanent records along with the committee's inspection reports and recommendations.

If the developer has not provided a maintenance manual, the committee should list maintenance responsibilities for specific items that are based on a review of the legal documents. This procedure informs board members and units owners of their responsibilities. Questions such as who repairs plumbing leaks and who maintains owner-added landscaping on the common areas are ones that may cause disputes and should be answered before they arise.

The maintenance committee also must review all existing maintenance contracts. It may need to help the developer-controlled board and the transition board develop detailed contract specifications, bid and review new contracts, and develop contracting procedures and maintenance specifications. This committee can aid the owners by reviewing existing maintenance procedures. It also can help the developer board by evaluating existing contracts and service providers' performance.

INSURANCE

Depending on the association's size and resources, insurance issues can be handled through a separate committee, a special ad hoc committee, or as a separate function under another standing committee, such as finance or management. Although the board decides on the renewal or replacement of insurance coverage, the committee can investigate insurance issues.

The committee reviews the association's documents to determine what coverage is required and then examines existing coverage to determine if it meets those requirements. In addition, it investigates any other coverage that is needed and then drafts specifications for securing competitive bids.

The insurance committee also can investigate various ways to minimize insurance

premiums—whether by increasing deductibles, installing a fire hydrant, or adjusting coverage for association employees. Finally, it can inform unit owners of what coverage the association carries and the unit owners' responsibilities.

COVENANTS, ENFORCEMENT, AND DESIGN REVIEW

During the development's planning phase, the developer determines initial areas for standards for unit owner behavior. The developer should establish as few rules and regulations as possible, adopting only those that are necessary to sustain the project design and type of community desired.

Rules that are adopted should be maintained and enforced—especially during the sales period. Lax enforcement is a bad sales technique—it results in unhappy owners who thought rules would be enforced and unhappy buyers who thought they wouldn't. This undermines owners' confidence and cooperation that forms the basis for the community. The developer must stress the importance of this aspect of association operation to those who sell and market the development as well as to association management.

The committee's scope of activity is dictated, in part, by the nature of the community, the form of ownership, and the complexity of the restrictions imposed by the legal documents. For many condominiums, the scope of enforcement is limited to "house rules" covering pet control, parking, and noise. Condominiums rarely have extensive demand for architectural review unless the development mainly comprises horizontal or townhouse units. Architectural review is more complex in homeowner associations. Because of the complexity of the architectural review function, associations that anticipate major activity in this area should set up a separate design review committee.

The covenants and rules enforcement committee reviews the documents for requirements regarding particular regulations and procedures. Then it reviews existing procedures, rules, and regulations to determine if they are adequate and if they need to be revised. It looks at the notice and hearing procedure for infractions, any appeals process, and a procedure for developing new or revised rules that allows adequate owner input. Once the evaluation of existing standards and procedures is complete, the committee investigates other areas that may need new procedures or regulations and begins to develop them.

The committee should provide owners with a copy of all rules, regulations, and procedures and regular reminders. It also needs to inspect the project periodically to ensure compliance with architectural standards and detect other visible infractions.

FINANCE

The development team should formulate a budget—including adequate capital reserves—that accurately reflects the estimated costs of all association services. The budget also should result in realistic assessments.

The board must collect assessments diligently during developer control to ensure the community's financial stability. The budget should reflect the procedure and formula to be used by the developer in paying assessments on unsold units. The developer is obligated by statute to pay 100 percent of the assessment on unsold units in most condominium associations. A lesser percentage payment is possible in homeowner associations. An affirmative statement of the procedure used for the developer's units—prepared and available from the first sale—eliminates much of the confusion that might occur later.

The budget can be a useful tool to educate owners about association operations once the initial budget and assessment fee levels have been set. Copies of the budget and appropriate explanatory material should be part of the orientation or welcome package provided to new owners. (Some states require associations to provide a copy of the budget to prospective purchasers prior to the sale as part of the disclosure package.) The developer's sales personnel, welcome committee, and finance committee should explain the budget and answer questions. The developer also should be sure that the association's financial records and books are maintained in a business-like manner and that all appropriate governmental reports and tax returns are promptly submitted. Copies should be included in permanent files.

The board should establish the finance committee as soon as it finds enough owner volunteers to staff it. This committee handles all of the association's financial affairs, including budgeting, assessment collection, financial procedures, books and records, and audits. It should review the association's financial records and procedures to understand the financial operation.

As owner control approaches, the finance committee should review procedures for expense approval and check-writing so that a workable system is available. The committee also should arrange for a certified audit of the books when majority control shifts to the unit owners. An audit protects both the developer and the owners and provides an undisputed basis on which association operations can proceed. The committee can help in interviewing and recommending an independent auditor. In states with statutes modeled after the UCIOA, the developer must pay for the audit. However, the association may pay for it if the developer pays full assessments on unsold units.

During the record review, the finance committee learns how the budget is developed. It determines what information is available—from association records and other sources—to set the budget. The management company or agent, if applicable, can teach committee members about procedures and resources. Prior to owner control, the finance committee can serve as a resource to the developer-controlled board when the budget is revised. Subsequent to owner control, the committee may prepare a proposed budget for board action or work with the management company to prepare it.

ASSOCIATION MANAGEMENT

It is important that the board runs the association as a separate business entity from the day it is created. The developer, during its period of control, is less likely to confuse association operations with development activities if it:

- Initiates and maintains separate books and records.
- Appoints a separate board of directors and records meeting minutes.
- Collects payments for maintenance items from the association.

Often, owners confuse the roles of the “developer-as-project-developer” and the “developer-as-controller-of-the-board.” This confusion often arises with warranty repairs. It is important to separate these repairs from association activities because the developer, not the association, is responsible for them.

A developer also can minimize owner concern for long-term contracts by signing contracts that can be cancelled after the owners assume control. If some of the contracts are with a developer subsidiary, it can minimize owner objections by disclosing the relationship and providing a cancellation clause.

The management committee reviews all management procedures. It then evaluates alternate forms of management (contract, on-site, volunteer). The committee also may study the overall committee structure, how committees relate to the board, nominations and election procedures, and service providers’ contracts and performance. It then can make recommendations to the board.

TRANSITION

The transition committee is a joint committee of owners and developer representatives that coordinates the transition process. The nature and composition of the committee depends on the structure the developer has chosen for phasing unit owners onto the board. If owners are elected or appointed to the board as certain levels of sales are reached, the board may serve as the transition committee.

Committee chairs also may be involved. If the association uses an interim board or committee, this group, plus one or two developer representatives may serve as the committee. However it is structured, the committee should have a relatively small number of owner and developer representatives.

This committee coordinates and facilitates transition activities. It ensures that other committees complete their review activities, develops needed recommendations, and helps resolve any remaining disputes between the developer and the association. The committee should be sure that all records, books, and files are current and complete and that the association is in good standing with all appropriate governmental bodies. In short, this committee is the coordinating and facilitating body for the actual transfer of control.

During the transition period, the transition committee should review the association’s declaration and bylaws for operational soundness, clarity, and relevance. Areas of inconsistency, vagueness, and over-regulation can be modified to improve association governance. The earlier these problems are identified, the more easily they can be corrected since fewer owners will be involved in the amending process. One word of caution, however: amendments to “clean up the documents” may work, but changes that go to the basic plan of development may have legal ramifications for the developer since owners have purchased in reliance on that plan. And if the association has a high percentage of non-developer owners, it will need a high level of involvement and concurrence to affect change.

THE EFFECT OF THE SALES PACE

If sales slow down, the developer—through the transition committee—may want to adjust the transition timetable to accommodate the pace of education and the specific interests and abilities of existing unit owners. Owners should become involved in association activities as soon as they move in, but early enthusiasm is easily lost if they feel their participation does not affect the association’s operation. This often happens when sales fall off and progress toward owner control is arrested.

If owners do not feel that they can affect decisions regarding association operations, they may simply rely on others to run the association for them. When sales eventually pick up and transition becomes a reality, early unit owners may not want to accept association responsibility. They may even become a permanently apathetic and resistant group. This reaction can hurt the association after the developer is gone. If a slow marketing period occurs, the developer should consider allowing greater owner participation that the sales level might warrant.

If sell-out occurs more rapidly than anticipated and owners are not properly prepared for turnover, the developer and the transition committee should advise owners of good sources of information on association operations. The developer or transition committee can provide the association with a CAI membership, hire an experienced management company or on-site manager, or offer consulting services to the association on a limited basis. Regardless of when sell-out occurs, owners should be sure to collect all pertinent documents and materials from the developer. (See Figure 4.)

FIGURE 4: ASSOCIATION TRANSITION CHECKLIST

The developer should provide the owner-controlled board with the following materials:

Association Documents

- Copies of Articles of Incorporation and acceptance by the Secretary of State
- Copies of the bylaws, including all properly adopted amendments
- Minute books and other books and records
- Copies of original or a certified copy of the declaration, as amended, and evidence that it has been provided to each owner
- Copies of all rules, regulations, and procedures adopted by the board
- Copies of all deeds of properties owned by the association or subject to the declaration
- Copies of all approved/disapproved architectural review requests.
- Financial documents
- Copies of annual state and federal tax returns since the date of incorporation
- Copies of any tax exempt election made by the developer's board and filed with the state and federal government
- Copies of the association budget, including backup worksheets
- A certified audit of the association's books from the association's inception to the date of the transfer of control that is prepared by an independent CPA
- A complete set of financial books, records, ledgers, and bills
- All association funds or control of them

FIGURE 4: ASSOCIATION TRANSITION CHECKLIST
(CONTINUED)

Maintenance

- A list of "as-built" drawings of all buildings, facilities, irrigation, and water and sewer systems that the association will maintain
- As many sets of tract maps as possible
- A complete set of landscape drawings and specifications showing all plants and lawns
- A schedule of quantities, such as square feet of roof, square feet of private roadway
- Inventories of all association property
- Copies of association equipment warranties
- Specifications and a list of manufacturers of paints and roofing materials used in common areas
- A complete list of the construction subcontractors and their principals
- Confirmation that city or county emergency centers have mapped the association for the dispatching of emergency vehicles and that private addresses are visible
- A statement of determination of public agency or utility responsibility for street lights and sewer systems maintenance
- A statement that appropriate public agencies have or have not released the completion bonds on the improvements where those bonds are required
- Copies of any certificates of occupancy and/or other permits issued by governmental bodies

Assurances

- A statement that the street, traffic, safety, and regulatory signs are installed in conformance with state or local ordinances and association documents
- Confirmation from local authorities that the fire hydrants were placed under the local government maintenance plan

Miscellaneous

- Copies of public reports, offering statements, or other disclosure documents, if any, that must be provided to purchasers
- A complete list of all owners with names and addresses of mortgage companies.
- Original copies of all contracts signed by the developer-controlled board
- Original copies of all association employment contracts
- All tangible association property
- All insurance policies in which the unit owners, the association, or its directors and officers are named as insureds

This checklist has been modified for nationwide applicability for this guide from a Checklist for New Associations prepared by Douglas Christison, Jr. for the Executive Council of Homeowners, in San Jose, California, and from the requirements of the Uniform Common Interest Ownership Act.

CHAPTER FOUR:

DEVELOPING LEADERSHIP AND INVOLVEMENT



THE DEVELOPER'S EFFORTS TO TRANSFER CONTROL WILL ACCOMPLISH LITTLE if new owners do not become involved. Unfortunately, developers and associations often are faced with owner apathy. Many owners are only interested in paying their assessments on time, obeying rules and regulations, and signing voting proxies—and those actions are important. But running the association requires more. Though owner apathy is a difficult problem faced by many associations, the board can minimize its effects during the development and sell-out phases.

After a new owner has purchased a home in the community and gone through the basic orientation program, the association should attempt to accomplish two goals:

1. Identify the skills and interests of each owner. This can be done through an interview or questionnaire.
2. Introduce owners to each other so they can begin to develop their identity in the community.

Thus, one of the first functions of committee activity is to facilitate these introductions. Whatever the name of the committee—social, hospitality, communication, orientation, or other—its purpose is to provide activities and methods for owners to become acquainted with each other and the association.

GENERATING VOLUNTEERS

Whatever form the committee mentioned above takes, there are key areas for action:

Welcome packet. The developer or the committee should develop a welcome packet containing basic association information, e.g., legal documents, rules, contact list for warranty work, answers to basic questions about the association, emergency numbers, a directory of owners, back issues of any newsletter, and an information form to assist new owners in identifying areas of interest to them.

New owner visit. A personal visit or phone call from a committee member along with a copy of the welcome packet provides an opportunity for new owners to ask questions.

Recognition. Peer recognition is one of the best ways to stimulate leadership. The developer can recognize work done by committees and their members. Bulletin boards—electronic or otherwise—and newsletters are good vehicles for recognizing active volunteers.

Meaningful involvement. The sense of being involved in association life in a meaningful way, that the effort an owner has invested in an activity is productive, and that an owner's involvement in decision making has a recognized effect all result in a positive experience for an owner and continued efforts to contribute.

Association visits. Providing opportunities for owners/leaders to visit other association and to talk to their board or committee members about experiences broadens the range of options available to them. Exposure to local and national organizations that provide educational materials and programs for association members helps make owners more confident about what they are learning.

Reality checks. Early involvement on a realistic level helps to ensure that, as additional complexity and responsibility develop, owners mature in their capacity to respond.

WORKING WITHOUT A TRANSITION PROGRAM

Although the educational programs and committee structure established in the development plan usually help motivate owners to participate in association activities, some developers do not prepare the association for transition. This may occur if the developer is bankrupt or if a lender takes back the property. Concerned owners should ask the developer: "What can we do to become involved in the association and to gain some measure of control over the situation?"

Expressing concern to the developer may be all that is needed, and the owners and developer can then work out a mutually agreeable program. It may be, however, that the developer may not understand or accept the value of early owner involvement and will not respond to owner initiatives.

Owner Concerns

Members can represent their own interests—regardless of the developer's response. First, concerned owners should meet to determine what issues affect the community as a whole and which ones are individual warranty problems that should be handled on a case-by-case basis between the unit owner and the developer. This meeting can take place at the association clubhouse, a member's home, or a nearby public meeting room. The owners should distribute an agenda in advance and assign a

person to take notes. Advanced planning can keep the meeting from turning into a gripe session. The concerns voiced at this meeting should be compiled and synthesized into a summary from which owners can determine what actions to take.

Owners who are interested in particular problems or areas of operation should organize a second meeting. During this meeting, they can organize action committees to investigate each subject. At this point, two things are happening—early association leaders are beginning to emerge and the owners are becoming more familiar with the scope of association operations.

Before a formal meeting with the developer, an owner representative should contact the developer with a general indication of the owners' concerns and activities. This will give the owners an idea about the developer's attitude. Owners should not assume that the developer does not want to cooperate with them. The developer simply may have overlooked a planned program for owner involvement and transfer of control. Of course, it is to the developer's advantage to respond to such owner initiatives in a positive way, both to prevent the appearance of mistrust and to continue to work cooperatively with owners for the association's success.

The owners should set up a meeting with the developer as soon as they have investigated areas of concerns, summarized them in writing, and developed suggestions for involving owners in association activities. The owners should have a list of concerns and some realistic suggestions of how they can be handled—not a long list of complaints. Suggestions may include a committee structure that advises the board and relieves it of some of the work required in bidding contracts and insurance, establishing rules, and determining owner opinions. It may include a communication network to provide information for a newsletter. Or it may include a recommendation for a better method of handling warranty problems. Some such owner groups provide the developer with a one-time, common-area punch list after all the work is completed. However, if reasonable attempts to work out differences fail and the developer is not responsive, owners should not hesitate to hire a lawyer.

In addition, owners should establish committees to monitor the developer-controlled board's activities, review funds disbursement and assessment collection, monitor enforcement of rules and architectural standards, register complaints where enforcement is lax, and monitor buildings and grounds maintenance to ensure it is adequate and meets required standards. Even though the owner's activities are not officially recognized by the developer and the developer-controlled board, these activities will benefit the owners:

1. Involved owners are exposed to many aspects of association operations and

learn what is involved in running the association—even if they can make no decisions at this stage.

2. The developer knows that its actions are monitored and, thus, is encouraged to be more responsive. Even if the developer isn't more responsive, the owners are more aware of what is being done and can file appropriate protests.

3. As owners learn about association operations, the developer-controlled board may realize that owners can contribute to several areas. The board may even allow the committees to perform some official duties.

An unresponsive developer is no excuse for owner inaction. Increasingly, the problem of unresponsive developers, or developers who are insensitive to owner involvement, is diminishing. When owners encounter such situations, they must be ready to assume responsibility to protect their investment.