Smooth Moves: Transitioning from Developer Control

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A critical event in the lifecycle of any association is the transition from developer to homeowner association control. The essential thing that happens when an association transitions is that the board of directors is elected by the owners. Understanding the "moving parts" is the key to a smooth transition.

Transfer of Board Control

The association is a nonprofit corporation, a separate legal entity from the developer that creates it. As a corporation, it is managed by a board of directors. The developer appoints the directors to the board during the period of declarant control, and the developer-appointed board controls the corporation. At transition, the developer appointees resign and the owners elect directors who control the business of the association going forward.

In a condominium, the transition of control is mandated by statute. After 25 percent of the total number of units has been conveyed, at least one member of the board must be elected by owners other than the declarant. That director gets access to all association documents and has one vote on the board.

When 50 percent of the total number of units has been conveyed, at least one-third of the board (usually a second person) must be elected by the owners, but the declarant still has control of a majority of the board. Finally, when 75 percent of the total number of units has been conveyed, the entire board is elected by the owners, and the declarant-appointed directors must resign and relinquish control. An alternate "trigger" requiring the declarant to cede control occurs by operation of law two years after the last conveyance of a unit or two years after the developer exercises a reserved right to add units, even if 75 percent of the units have not yet been conveyed.

The rule is entirely different for homeowner (i.e., non-condo) associations (HOAs). The HOA statute is silent on transition of control, thus the governing documents control. Often the developer has the right to appoint all directors and thereby control the association until the very last lot or home is sold, although it can voluntarily relinquish control earlier by recording an amendment to the declaration surrendering control.

Obligations at Transition

One of the confusing things about transition of association control is that no "turnover meeting" is required by statute. This can leave the developer and the homeowners uncertain about what their obligations are, and when they attach.

Under the Condominium Act, the owners must elect a board within 30 days after the period of declarant control ends. Fixing the date when the period of declarant control ends is tricky, because it depends upon knowing when 75 percent of the total units that can be created under the declaration have been conveyed, and then adding 60 days. For example, in a 100-unit condominium, if the 75th unit is conveyed on September 1, the period of declarant control ends 60 days later (October 30) and the owners must elect a board 30 days after that (i.e., by November 29). The owner-elected board takes office upon election.

The declarant must deliver a virtual raft of documents to the association within 60 days after the period of declarant control ends. These include, among other documents: Written resignations of directors appointed by the declarant; all financial records including canceled checks, bank statements and financial statements from date of incorporation through transfer of control; an audit of the financial statements by an independent CPA as of date of transfer of control; contracts and leases to which the association is a party; insurance policies; and the plans and specifications used to construct the condominium. The declarant must also deliver all association funds and tangible personal property. It is the owner-elected board's responsibility to ensure that all required items are delivered.

Again, however, these rules apply only to condos and not to HOAs, since the HOA Act imposes no transition requirements. It provides only that all financial and other association records are the property of the association.

Pre-Transition Contracts

If the developer-controlled board of directors entered into a contract pre-transition, the owner-elected board can terminate the contract at any time without penalty on 90 days' notice if the contract is: (1) a management contract, employment contract or lease of a parking or recreational facility; (2) a contract or lease with the declarant or an affiliate of the declarant; or (3) a contract or lease that was not bona fide or was unconscionable to the owners when made. Note that termination of such contracts can occur "at any time." There is no requirement that the owner-elected board terminate them right away. Other contracts entered into by the developer board pre-transition remain binding on the association.

Liability of Original and Successor Declarants

Another complex issue involves a developer that transfers unsold units and development rights to a successor declarant. What are the responsibilities of the original declarant and the successor declarant? The short answer is that transfer does not relieve the original declarant of any obligation that arose pre-transfer, including the duty to pay assessments on declarant-owned units and warranty obligations to both original unit purchasers and subsequent purchasers on improvements constructed by that declarant.

The successor declarant is not liable for the contractual obligations of the original declarant or for warranty obligations on improvements made by the original declarant, unless the successor is an affiliate of the declarant. Otherwise, the successor is only liable for its own obligations and for warranty obligations on additional improvements it constructs. A successor by foreclosure can limit its liability by recording an instrument stating that it holds the units solely for resale.

Unfortunately, convoluted successor-declarant arrangements are common and can sometimes impair an association's ability to enforce its warranty rights. These arrangements warrant special vigilance by the owner-elected board.

Conclusion

Got all that? Fundamentally, transition of control means a change in who selects the directors to serve on the board, but it also involves delivery of important documents and property, potential termination of contracts, and complex successor declarant issues. To assure a smooth transition, know your rights, plan ahead, and get assistance from your manager and legal counsel.