

TRANSITIONING FROM THE DEVELOPER TO HOMEOWNER CONTROL

Steven L. Sugarman, Esquire

Transition is a concept which is frequently misunderstood in the community association arena, but it is also one of the most important phases in the evolution of a community association. As such, a keen understanding of the concept, including the rights and responsibilities of both the developer and the homeowner-controlled board of directors, can go a long way in avoiding conflicts and controversies and establishing a successful community for the long term.

Transition generally refers to the process by which the control of the community association, through its board of directors, is "turned over" from the developer to the homeowners. The transition should be viewed as a process and not a singular event. The transition process is rooted in the association's governing documents and our statutory law. Those governing documents include, specifically, the association's declaration of covenants, conditions and restrictions, the bylaws; and the statutory laws in our Commonwealth of Pennsylvania include the Uniform Condominium Act and our Uniform Planned Community Act. (These statutes will be referred to as the "Acts".)

This transition process can be enhanced significantly through contributions made by third-party professionals, including attorneys, engineers, architects and other professionals. It is also extremely helpful for an association's board to utilize homeowners and representatives of the developer on a transition committee. Property managers, well-trained and experienced in the affairs of community associations, can also serve as helpful participants in the transition process. Although the practice is not often followed, it remains in the best interests of the association for the declarant-controlled board to hire independent legal counsel to represent the interests of the community association, even before the baton is passed from developer to the homeowners. Such a practice avoids those conflicts of interest that are likely to arise if the developer continues to use its own counsel to represent the interests of the association during the transition process, and further provides the association with an opportunity to consult and work with its own legal counsel.

Under the Acts, transfer of control through the composition of the board is required to start after the developer conveys 25% of the units to purchasers. At that time, at least one (1) member of the executive board is to be elected by the unit owners and not appointed by the declarant. After the conveyance of 50% of the units to third-party purchasers, no less than one-third of the members of the executive board are to be elected by the unit owners. However, pursuant to our statutory laws, the declarant must turnover control through an election meeting of the membership no later than after 75% of the units are conveyed or within five (5) years or seven (7) years of the date of the first conveyance of a unit, depending upon the type of community established by the declarant.

It is important to note that a declarant may voluntarily surrender control of the board of directors at any time before the time mandated under the Acts. In so doing, the declarant may require that certain actions of the board of directors be approved by the declarant during that same period of declarant control by describing such limitations and actions in a recorded instrument executed by the declarant. This procedure authorizing the declarant to turnover control earlier than the mandated statutory date provides a marvelous tool for the association and developer to structure, by an agreement, an orderly and efficient transition process by removing the developer from the day-to-day governance and administration of the association while, at the same time, preserving the developer's rights to build, market and sell the units.

Pursuant to the Acts, and not later than sixty (60) days after the period of declarant control terminates, the declarant is required to deliver to the association all property of the unit owners and of the association held or controlled by the declarant, including such items as copies of the recorded governing documents, tax returns, all association funds, plans and drawings of the buildings and improvements, insurance policies, permits and warranties and other pertinent documentation. Moreover, the homeowner-controlled board is given an opportunity to review and evaluate all contracts and leases that may have been entered into by the executive board during the period of declarant control and may terminate such contracts and leases upon not less than ninety (90) days notice to the other party. The contracts and leases which may be terminated include, among others, any management contract, employment contract, or lease of recreational or parking areas and any contract or lease to which the declarant or an affiliate of the declarant may be a party.

What else should the new homeowner board do after control of the association is ceded by the declarant? First, it is important to understand that the board members stand in a fiduciary relation to the association and are required to perform their duties in good faith and in a manner they reasonably believe to be in the best interest of the association. In performing those duties, the board members are entitled to rely upon the advice and opinions of third-party professionals, including legal counsel, accountants, property managers and others. As such, and consistent with this standard of care, the new executive board should promptly select competent counsel to represent the interest of the association in dealing with the turnover of control from the declarant, especially if the declarant failed to retain independent counsel for the association during the period of declarant control.

As part of the homeowner board's due diligence, the board should promptly begin investigating the financial condition of the association, including the adequacy of the operating budget and reserves set aside during the period of declarant control, as well as the amount of any assessments which may be due from the developer. Our Legislature recognized the importance of an accounting study at the time of transition and imposed a requirement under the Acts for the association to perform an audit of its finances not later than ninety (90) days after the termination of declarant control. The costs of that audit are required to be shared equally between the declarant and the association.

Likewise, the homeowner-controlled board should investigate and assess the condition of the common elements for which the association will remain responsible, including such things as the exterior components of the units (such as the roofs and exterior siding), sidewalks, roadways, stormwater management facilities and the like. Once again, to assist the board in this evaluation, the board should consider retention of third-party engineers, architects and other consultants. Such actions would enable the board of directors to be guided by such third-party professionals, and most importantly, insure compliance with the fiduciary standards articulated in the Acts.

Typically, the transition process is consummated through the negotiation of a transition and settlement agreement that runs between the association and the declarant. Although there is no legal requirement for the parties to enter into such an agreement, it is certainly a prudent practice to do so and has the advantage of effectuating an appropriate divorce between the association and the declarant.

Throughout this transition process, it is consistent with sound practice for an association's board to be as transparent as possible in the disclosure to the unit owners of what's taking place. This is especially important with respect to any litigation initiated by the board as well as any settlement achieved between the parties.

An effective way to maintain communication between the board and the unit owners is to host one or more informational meetings where the community members can be apprised of what the board is doing or has done in the transition process and provide an opportunity for the unit owners to receive answers to their questions. To assist with these communications, the board may wish to consider inviting the association's consultants, including legal counsel, to participate in the membership meetings. These kinds of informational meetings provide an excellent opportunity for the membership to gain a better understanding of the transition process and the goals set and achieved by the board of directors, and ultimately, provide a strong foundation for a smooth transition process and a successful community association.