

# A Guide to Transition

**Common Interest Developments:**

**The Keys to a Successful Transition  
from a Developer-Controlled Board to a  
Member-Controlled Board**



ABOUT

# Berding & Weil LLP

**Berding & Weil LLP** provides experienced, comprehensive, and practical legal counsel to community associations throughout California. We represent clients with real property, construction, and general business concerns, as well as those dealing with local government agencies about planning, easements, and other land use issues. Members of the firm advise boards and managers on day-to-day corporate operations, general litigation, and complex construction defect claims.

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# **BERDING & WEIL'S GUIDE TO COMMUNITY ASSOCIATION TRANSITION**

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**Keys to a Community Association's  
Successful Transition from Developer  
Control to Homeowner Governance**

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# Introduction

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Over more than two decades, we have assisted thousands of directors manage their homeowner or community associations. Serving on a board is not easy; the challenges are great, especially during the early life of the association. The developer representatives on the board frequently have a great deal of experience serving on other boards while in the developer's employ; the developer controls the board and the key association documents and its interest is usually in maximizing future sales. The homeowner directors on the other hand, only and always join the Board after the developer appointees have been in power, and homeowner directors typically have little experience serving on a board, no political power to get things done since they lack the votes to dictate board action, and may be "caught in the middle" between the demands of the homeowners and the developer's sometimes less than cooperative behavior. Disputes can arise.

*Some* developments are built defect-free and easier to maintain and so the potential for conflicts with developers is limited. *Some* communities are smaller, sales are relatively fast and developer representatives do not serve on association boards very long. *Some* developers are very responsive to the needs of homeowner directors and work hard to maintain good relations. Other community associations – too many – are not so fortunate.

This booklet was written to assist homeowner directors in successfully navigating the early and critical time in the life of an association. The theme is simple: directors who educate themselves can do an excellent job representing the interests of their members; education requires getting the right documents and in regard to financing and maintenance, getting timely expert advice.

While based on our many experiences representing homeowner associations during the early – and in fact at all – stages of a community's development, the information and legal analysis provided here is general. The legal, political and

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financial issues faced by each new board, and each community will vary based on their particular governing documents, the cooperativeness of the developer, the support of the members and many other considerations. Our book is a beginning and, we believe, will provide the directors the help they need in serving their community.

One final note: if you are reading this, you probably know that homeowner association operations are regulated by numerous laws, including the Davis-Stirling Common Interest Development Act. Originally enacted in 1985, it has been amended more than 200 times since its inception. This year (2012) the Act was completely renumbered and revamped with the new changes becoming operative on January 1, 2014. The Davis-Stirling references in this book are to the statute numbers that will be used on and after that date.



# Chapter 1

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## What is Community Association Transition?

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Transition is a term that describes the process by which the developer of a common interest development passes ownership, governance and responsibility to the members of the association. The transition process is not a single event, such as the election of members from the association to control the board of directors (“board”); rather, it is a multi-stage series of many events taking place over months or, sometimes, years. Transition reflects the period during which the developer conveys control of a multi-million dollar real estate project to the members. At the conclusion of transition, the member elected board of directors, usually with the assistance of a community association manager, becomes responsible for the management and preservation of assets worth millions of dollars and the hopes and dreams of homeowners, frequently first time buyers. A smooth transition ensures that operation of the multi-million dollar real estate enterprise gets off on the right foot.

When a community association is developed, the developer devotes a large amount of time and resources to the construction of its project and sales of homes and condominiums (referred to here for convenience as “homes”). Among other things, the developer will obtain land, engage design professionals and contractors and obtain government entitlements, including the approval to sell homes from the California Department of Real Estate (“DRE”). Even before ground is broken, the developer will create a non profit corporation to operate the association and documents necessary to do so, including the governing documents, including articles of incorporation, bylaws and a recorded Declaration of Covenants, Conditions and Restrictions (“CC&Rs”).

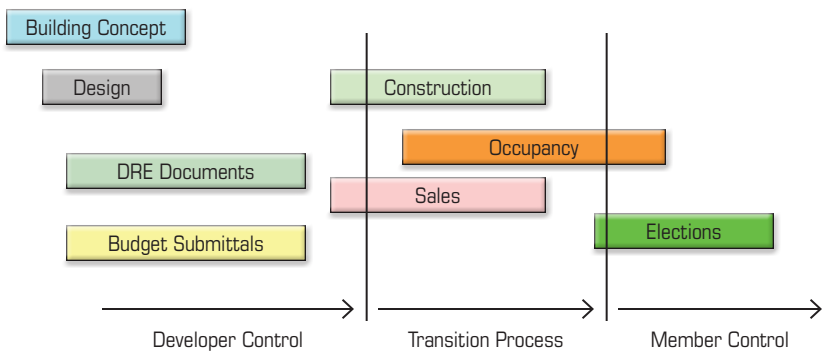
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In order to protect its investment and to have maximum flexibility during the sales process, the developer builds into the governing documents various provisions that assure control of the board and thus the direction and processes of the community during the transition period. During this time, the developer appoints representatives to serve on the board; it controls the votes (having 3 votes for every property owned as permitted by DRE regulations), and determines the budget, the level of assessments imposed to finance operations and the management company.

The period of transition from a developer-controlled board to a member-controlled board is very important to the stability of the association. Over time, as more homes are sold, the association becomes independent of the developer's support and matures into ongoing governance by the owners. A wise developer educates owners about the association even before the first residents move into the development and keeps up this effort during the entire transition process. This way, when the developer leaves the project, and control passes completely to the member-controlled board, the association's operations can proceed smoothly.

The newly elected homeowner board members have a large responsibility during the transition process. They should ensure that:

- The developer provides the association all pertinent information such as governing documents, financial documents, permits, warranties, building plans, insurance information and maintenance manuals;
- The association reviews the information received from the developer and actively seeks to obtain documentation or resolve vague or ambiguous issues concerning the development;
- The new board develops a strategy for moving forward with their governance;
- The association common areas are in proper shape and well-constructed; and
- The association’s operating budget is adequate for all ongoing operations and sufficient to finance long term replacement of components.





# Chapter 2

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## Transition Team Members and Their Roles

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This chapter will introduce the players involved in the transition and their roles throughout the process. The transition team consists of the developer, the owner-controlled board of directors, the original property manager and in many cases the new property manager.

### I. The Developer

The developer and the management company it hires for the association are through experience and planning, often more prepared for the transition process than the newly-elected board members who may never have served on a board, prepared budgets, dealt with contractors or even owned a home. However, when the time arrives for the final transition, the homeowner directors must be ready to “step up” and the developer may have no more than a skeletal crew to assist the owners and the present property manager with this final, yet very critical phase. Some developers are more adept than others at assisting the transition team to help realize its goal of getting the newly appointed owner-controlled board off on solid footings as it embarks on self-governance.

### II. The Owner-Controlled Board of Directors

Early in the transition process, the owners will have the chance to elect one director, then another and, as the developer sells more homes, more and ultimately all directors, The owner-members elect the board of directors to oversee the business of the



association. The board must conduct its business with reasonable transparency to gain the confidence and support of the association's members.

During the transition, the first order of business for the owner-controlled board should be to decide which directors or executive committees (committees comprised of some but not all members of the board) will perform which tasks. A balanced division of labor will lead to the best possible result. Tasks during this period might include verification that documents have been received (including the existing property management contract); attain an understanding of what they say; review the common areas being "turned over", and communicate with members and others (such as existing vendors).

The second order of business for the owner-controlled board is to decide whether to keep the existing property manager, often selected by the developer. If the new board decides to replace the existing manager, the board members must conduct a diligent search for a replacement and perform an adequate investigation of each of the candidates. If the board hires a new property manager, the board members must ensure the old manager cooperates with the new manager and helps to educate him or her about the project and the association and its members.

To help ensure their cooperation, the board should meet with both managers and set forth the ground rules and the board's expectations and remind both managers that they are expected to work cooperatively with each other in order to help the association achieve an orderly transition. Friction between the old manager and the incoming manager is not uncommon. The directors need to be alert to any friction that may arise between the two managers because any hostility will hamper the transition and create a steeper learning curve for the incoming manager. Investing time and energy up front will significantly reduce the likelihood that problems will emerge after the previous manager has left the job.

During this process, the board may require the assistance of a community association attorney to help them better understand the governing documents and the legal obligations of both the association and the developer throughout the transition process. An attorney can guide the board when it enters a transition agreement with the developer.

### **III. The Original Property Manager**

Developers almost always hire the initial property manager. Many sophisticated developers often begin working with an experienced property manager even before the homes are offered for sale to the public. The property manager can then help the owners with the move-in process.

Property managers are critical to the wellbeing of an association because they are responsible for several different

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aspects of an association. For example, they assist in the day to day management such as maintenance and preservation of the common areas. They also help the association in enforcing the governing documents such as the Bylaws and CC&Rs.

Because the original property manager was present from the first sales of the units, the newly appointed owner-controlled board will rely heavily upon the knowledge of such property manager during the transition process. The property manager should know which documents the developer has in its possession, and which documents must be provided to the association. The association's directors should frequently meet with the original property manager and ask questions, to become familiar with the "ins and outs" of the association and what to expect during the transition period or with basic operations like budgeting and maintenance.

The property manager can provide general guidance to both the developer and the owner-controlled board during the transition process and may serve as a liaison between the developer and the owners with respect to repairing outstanding punch list items and damages covered by warranties. The property manager might be able to help the owner-controlled board find independent legal counsel to handle the legal issues that may arise for the association.

The property manager should arrange for a thorough walkthrough of the entire property with the owner-controlled board and the developer's representatives. The walkthrough should include an inspection of all major operating systems and components, including the fire-safety systems, HVAC systems, boilers, water, trash chute, elevator, exterior cladding and roofing systems, and the window assemblies. It is helpful to bring on this walkthrough the original reserve study which in theory lists all components with a life less than 30 years that the association is required to maintain and replace.

The original property manager can be a useful tool for the association during the transition process. After the newly appointed board is in place, the association should utilize the knowledge and skill of the original property manager, to help ensure a smooth transition.



## **IV. The Incoming Manager**

The association may elect to replace the original property manager with a new property manager of their own choice.

The incoming manager must be proactive in working with both the board and the old manager to develop a thorough understanding of the project. It should study the project's major components, any issues regarding the common areas, safety of the association's members, and the state of the association's financial affairs. The incoming manager will also need to be proactive in developing relationships with board members, employees, independent contractors, and other personnel.

If the new members of the board have not already done so, the new manager should help the board arrange a thorough walkthrough of the property with the board, the original manager, and the developer. The walkthrough should include an inspection of all major operating systems and components, including, depending on the development, the fire-safety, HVAC, boiler, water, trash chute, elevator, exterior cladding, roofing, and window assemblies and systems. The walkthrough should include a review of all those components listed in the maintenance manual that are the association's responsibility.

### Key Points - Chapter 2

A successful transition requires teamwork and cooperation from the project's key players:

- The Developer
- The Owner-Controlled Board
- The Original Property Manager
- The New Property Manager



# Chapter 3

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## Governance of Common Interest Developments

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Since 1985, common interest developments in California — such as community apartment projects, condominium projects, or planned developments — are governed by The Davis-Stirling Common Interest Development Act, codified in California Civil Code §§ 4000, *et seq.* (after January 1, 2014).

As part of the development process, the developer typically creates and incorporates a community association, and elects representatives (generally of the development team) to serve on the board. The association is run and controlled by a board of directors, whose official conduct and actions are governed by the governing documents and numerous homeowner association laws, including those contained in the Corporations Code.

California corporation law imposes upon each director a fiduciary duty to act in the best interest of the association. In practice, each director’s “job performance” is measured by what courts refer to as the “business judgment rule.” Essentially, each director must act in the best interest of the association and perform his/her duties and responsibilities as an ordinarily prudent person would under similar circumstances. The interests of the association reign supreme over any member’s individual interests. Thus, each director must subordinate his or her personal interest to that of the association’s interest when he/she is handling the business of the association.

The primary function of the board is to protect the financial and legal interests of the association. Good governance requires that the board formulate strategies and set policies that the board members reasonably believe will promote harmonious living

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in the community, enhance the value of the common assets, and ensure and improve the long term viability of the association's financial assets (e.g., reserves set aside for capital improvements). The board delegates the day-to-day operational duties to the property manager and oversees his/her performance. Owing to changes in homeowner association law, more and more boards are also delegating certain responsibilities to executive committees of the board.

A discussed above, the developer also prepares and records the documents which serve as the "constitution" of the association. Those documents are referred to as the governing documents, and include the articles of incorporation, bylaws, the CC&Rs and rules. Like the United States Constitution, the governing documents of a community association are living documents, subject to amendments by the membership and interpretation by the board of directors. Essentially, the governing documents are codes of conduct by which members are expected to live and interact with one another within the community and use and access the common areas and assets that belong to the community association or are owned jointly with other members. Generally, the articles and bylaws address "corporate" issues while the CC&Rs dictate the use of common area and property owned by the members (and technically referred to as "separate interest" property).

The business judgment rule provides the board of directors with essential protections in exercising its discretion when interpreting the governing documents and making decisions on association operations. When making decisions on association and community wide issues, directors who act in good faith and in a manner that they believe to be in the best interests of the corporation are generally protected from lawsuits. By consulting with experts and legal counsel and obtaining certain specified levels and types of insurance, the decisions of a board of directors can more easily withstand attack and second guessing and the directors can avoid personal liability.

# Chapter 4

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## Preparation of the Documents – What Documents Should the Board of Directors Request from the Developer?

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The transition of records from the developer-controlled board to the member-controlled board is essential to a successful and smooth transition. Transfer of these documents requires not only cooperation from the developer and the developer-controlled board, but also a thorough review of the documents by the member-controlled board once they have been transferred. Listed below are the five major categories of documents and records that should be transferred and reviewed before the members control the board.

- Legal Documents
- Day-to-Day Documents
- Financial Documents
- Maintenance and Building Records
- Miscellaneous Documents

These records should be formally requested in writing by the Association's lawyer, its property manager, or one of the Association's directors authorized to make the request. The reason to make the request in writing is to properly document the date when the request was made, to serve as an official record of the Association, to set a time frame for delivery, and to properly characterize the importance of the request.

As the records are transferred or otherwise accounted for, there should be a checklist to make the accounting or a receipt to document and inventory the same. A book listing can be made or an electronic record stored to show that the document has been

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secured. If records are missing, follow-up requests should be made to find and or re-create the record or to explain one or more missing records or materials.

If by chance there is resistance or an objection to the production or transfer of a particular record, the Association's attorney can be enlisted to help with the process.

The next few chapters provide a detailed description of all the documents included within these five categories and why transferring and reviewing these documents are important for a successful transition. To help keep track of which documents have been received by the member-controlled board, we have prepared a checklist of all the documents listed in the next five chapters. The checklist can be found at the end of the booklet.

# Chapter 5

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## Legal Documents

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There are several legal documents that the association should request from the developer during the transition period. Among the most important legal documents are the CC&Rs and any amendments to the CC&Rs, budgets, and the association's rules. This chapter details the most important legal documents that should be transferred during the transition process. The member-controlled board should always consult an attorney if it has any questions regarding any of these documents.

- Easements
- Special Agreements with Government Agencies or others
- Recorded or Filed Maps, Condominium Plans and Deeds
- Development Agreements
- DRE Public Reports and Budgets
- Governing Documents
- Bylaws
- Association Rules (including Election Rules)
- Policies mandated by the Davis-Stirling Common Interest Development Act
- Architectural Approval Request Forms and Forms Granting/Denying Requests (and records confirming architectural approvals given by the developer-controlled board)
- Insurance Policies

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- Notices of CC&R violations
  - Legal Opinions
  - Minutes of board meetings and decision making committees

Some of these documents are discussed in more detail below.

## **Easements**

An easement is defined as the right to use another person's real estate for a specific purpose. The most common type of easement is the right to travel over another person's land, known as a right of way. In addition, property owners commonly grant easements for the placement of utility poles, utility trenches, water lines or sewer lines. There are several different types of easements (i.e., public vs. private, appurtenant vs. in gross), the details of which are not important for purposes of this guide. Most easements are recorded against the property they affect. Some easements are also contained within the CC&Rs themselves.

One of the incidents of ownership of a condominium is a nonexclusive easement for ingress and egress through the common areas. Generally, the common areas of a condominium project are subject to these rights held by each of the unit owners. The association is not only responsible for ensuring compliance with the governing documents, but also that the easements through the common areas or restrictive easements are followed. Therefore, the association should be aware of any easements detailed in the governing documents and fully understand the rights and responsibilities charged upon them to enforce the easement.

## **Special Agreements, Developer Agreements, and Other Agreements**

On occasion, the developer and the board may enter into special agreements concerning the common interest development. If any special agreements were made, the member-controlled board should be aware of them and request copies of any document related to the agreements. California law imposes



special requirements on certain types of agreements between the developer and the association during the early stages of its developments and a board should consider having counsel review the more significant of these.

### **Recorded or Filed Maps, Condominium Plan, and Deed**

California Civil Code section 4285 defines “condominium plan” as a survey or map of a condominium project which identifies the common areas and each separate interest area. The condominium plan must sufficiently identify the accurate location and description of all the units as well as an accurate designation of all areas (i.e., the common areas, restricted areas, parking, etc.). Similarly, a deed transfers title to another person and must describe the real property, name the person transferring title (grantor) and the person receiving title (grantee), and must be recorded with the county recorder.

During the transition process, it is crucial for the newly-elected member board to request from the developer all documents that bind the Association or its members and which are recorded by the county recorder’s office. This includes condominium map or plan and the deed to common area property to ensure that the board understands which areas are designated common areas and which are designated as separate interests and what rules govern their use.

### **DRE Public Reports and Budgets**

The Department of Real Estate (“DRE”) sets forth policies and procedures for developers in order to ensure the developer complies with the real estate and subdivided land laws when offering homes or condominiums for sale to the public. To make sure the developers comply with the real estate laws, developers must apply for and obtain a so called Public Report from the DRE. The DRE Final Report is often referred to as the “White Paper.” Public Reports contain important information for prospective buyers including information about special use conditions, soil reports, schools, and the level of assessments the owner will be charged to finance association operations. As such, it is important

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for the newly elected board to obtain copies of the DRE Public Reports for its records. Frequently, there will be several versions of the Public Reports, especially for phased and larger developments or those subject to a lengthy sales process.

The assessment levels identified in the Public Report are based on a budget submitted by the developer as part of the DRE approval process. It is important that the board obtained that budget. It will normally be adequate for the association for the first year of operation. However, after the first year of control, the new board would be wise to review the budget to determine if it is an accurate representation of the project's actual operational costs. If the budget is found to be deficient in some manner, the board has the power to amend or adjust the operational costs, and if the review shows that the developer failed to properly account for all reasonably expected costs and expenses, the Association may have a claim to make against the developer for underfunding the Association's operations and setting it on a course of financial demise.

## **Declarations of Annexation**

A Declaration of Annexation is another document that the developer is required to file with the DRE and record with the County Recorder's office if the project consists of more than one phase. It is often filed at the completion of each phase of the project. A Declaration of Annexation is a written declaration by the owner/developer that the particular phase is officially part of (or annexed into) the project. As such, the homes within that phase may be sold, leased, transferred, occupied and conveyed pursuant to the terms of the other governing documents. These declarations are important to have as part of a complete DRE file.

## **Governing Documents: CC&Rs, Articles of Incorporation and Bylaws**

**CC&Rs** are covenants that bind the use of land and set forth rights and limitations on how the property or community association is used and operated. They are recorded with the County Recorder's office. They contain a legal description of the

common interest development, identify the type of development, and set forth the restrictions on use or enjoyment of the property. The CC&Rs will include, for example, all of the essential provisions for the operation of the development, such as voting rights, use restrictions, maintenance responsibilities, and a description of the powers of the board of directors.

During the transition process, it is essential for the new board members to request a copy of the recorded CC&Rs from the developer, and to review them carefully when received. It is highly advisable for the new board to enlist the aid of an experienced attorney to assist with this task.

A complete understanding of the CC&Rs is important because the Association is responsible for enforcing them against all current and future homeowners (and, alternatively any owner can enforce them against the Association if it is not properly carrying out operations). The member-controlled board should avoid the situation where it may have to enforce rules and regulations with which the community does not agree. Therefore, a board should always be alert to potential amendments to the CC&Rs to reflect community preferences, such that it can comfortably enforce them.

**The Articles of Incorporation** is the document that creates the corporate association entity and is filed with the Secretary of State. The Association's Articles of Incorporation state the purpose of the Association and its place of business, the powers granted to the Association and other broadly stated powers and purposes of the Association.

While the CC&Rs define the limitations on how the property is used and the Articles of Incorporation form the corporation, the **Bylaws** establish the administrative procedures for carrying out those responsibilities. They contain the rules for the operation of the Association and define the powers and the manner of exercising those powers for the board and each of the Association's officers. They pertain to matters such as membership meetings, elections, voting rights, and similar administrative matters. As with the CC&Rs and Articles of Incorporation, the Bylaws should be carefully reviewed and amended as necessary by the newly-elected board.

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## **Association Rules**

In addition to the rules outlined in the governing documents, the Association may have its own separate set of operating rules that cover very specific topics. For example, the Association's rules may limit the size and number of pets an owner can have, whether an owner can install a basketball net on the street or sidewalk in front of their home, or may limit how the common area is used. These types of rules typically go above and beyond the "boilerplate" rules set forth in the governing documents, and are tailored to meet the needs of each community association. As with the governing documents, if the developer has drafted a set of association rules, the newly elected board members should request a copy and review and revise them, if necessary. It is especially important that the new board obtain (or create) a set of election rules. This is mandated by California law and those rules dictate voting procedures for elections, assessment increases, and governing document amendments (and for the approval of certain types of easements).

## **Policies Mandated by the Davis-Stirling Common Interest Development Act**

The Davis-Stirling Common Interest Development Act ("Davis-Stirling Act") was passed by the Legislature in 1985 and contains the statutory provisions regarding the creation and functions of common interest developments in California. It is covered in California Civil Code sections 4000 - 6000.

The Davis-Stirling Common Interest Development Act sets forth provisions governing declaration amendments (Civ. Code § 4275), financial statements for the association (Civ. Code § 5300), review of accounts and reserve requirements (Civ. Code § 5350), limitations on assessments (Civ. Code § 5600), and preparation of the association's budget (Civ. Code § 4800), among others.

## **Architectural Approval Request Forms and Forms Granting/Denying Requests**

The member-controlled board should be aware whether it must obtain prior approval from the developer's architect before making any significant renovations or changes to the common areas of the project. For example, if there are to be any new fence additions to the exterior of the property, the developer's architect may specify the type or style of fence, the type of materials used, and the height requirements for the fence.

In order to ensure the fence is constructed according to the architect's specifications, the architect may have an Architectural Approval Request Form which the Association is required to submit to the architect prior to making any changes. The architect or architectural committee will then review, approve, or deny the request.

During the transition process, the newly-elected board should request documentation from the developer regarding any procedures required by the architect prior to making changes to the common areas. Also, the board should ask for any architectural rules put in place by the developer since they will dictate the procedures the Association must follow in evaluating requests for architectural changes and procedures for appeal of architectural committee decisions.

## **CC&R Violation Letters and Notices of Violation**

The board of directors is charged with the responsibility of enforcing the governing documents and Association rules. Generally, the governing documents will provide that before any fine or penalty is imposed on an owner, reasonable notice and an opportunity for a hearing be granted to the accused owner, in order to protect that owner's due process rights. If, during the developer-controlled board period of governance, any owner was provided a notice of violation or a letter indicating a violation, it is important that the newly-elected board maintain that record in the owner's file until the owner no longer lives at the property so that future owners will be on notice of the violation.

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## **Legal Opinions**

When a developer representative asks, in his capacity as board member, counsel for the developer about a specific legal topic the attorney will perform legal research, and then will frequently put their answer or opinion in writing. A responsible developer should retain copies of all legal opinions provided by their attorney during the course of construction and during the period of the developer's board's control. The newly-elected board should also retain a copy of all legal opinions provided by the developer's attorney in order to have a complete record of legal advice given by the attorney in the past.

## **Insurance Policies**

Typically, the developer will ensure the community with a property insurance policy and will ensure the operations of the Board of Directors with a Director's and Officer's insurance policy. There may also be other insurance secured by the developer as well, such as an employment policy covering employees of the Association and or Commercial General Liability insurance for Association activities. The newly-elected board should get full copies of these policies and should have them reviewed by its own broker or attorney to review compliance with the Association's governing documents and the coverage objectives for the new Board of Directors.

## **Minutes of board meetings and decision-making committees.**

Most responsible developers maintain appropriate minutes of board meeting and decision-making committees that were operational under their supervision. The extent of the minutes varies and depends on the issue, but there should be minutes that mirror the meetings that were held and the decisions that were made. These should be collected together, reviewed for understanding, compliance, and subsequent action, and stored in chronological order. The new homeowner- comprised board should continue its next-in-order minutes behind the last minutes from the developer-controlled board.

# Chapter 6

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## Day-to-Day Operational Documents

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This chapter briefly describes the “day-to-day” operational documents and records the Association should request from the developer during the transition process. These records are important for the daily operation of the Association, and should not be overlooked. Most of the documents listed below are self-explanatory and are therefore not discussed in any detail. However, if the member-controlled board has any questions regarding the importance or relevance of any of these documents, it should consult an attorney.

- List of Members’ Names, Contact Information and Emergency Contacts (Mailing Addresses, Telephone Numbers & E-Mail Addresses)
- List of Owner “opt outs” of Membership Directory Contact Information
- Parking and Parking Sticker Information (Vehicle Type and License Numbers)
- Voting Records, Form Notices, Ballots, Proxies
- Service Contracts
- Insurance Certificates and Broker Information
- Pending Insurance Claims
- Disclosures to Owners re Pending Legal and Claim Matters
- Newsletters
- Keys

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- Minutes and Resolutions Books (member, board, committees)
  - Unit/Lot Files
  - Open Escrows
  - Pending Special Assessment Information
  - Management Reports and Agendas

It is extremely important for the new board to make sure they have a complete and up-to-date list of the members' names and contact information, including information about renters. This is important for any homeowners association, whether there are 20 owners in the development, or 220, or 2200. Because owners constantly move out or rent their homes to tenants, it is highly recommended that during the transition process, the new board members ensure they have the most up-to-date list.

### **Parking and Parking Sticker Information (Vehicle Type and License Numbers)**

If there is assigned parking at the development, the new board will need to ensure that all parking information is received from the developer, including all parking space assignments, placards, stickers, etc. Similarly, the board will need to request any parking procedures, rules or regulations and information about previous parking violations. Also, if the homeowners are charged a fee for parking, the new board should request the fee schedule and whether there are any outstanding parking fees owed. Warranty information concerning entry gates to the development and similar equipment is also important to obtain.

### **Voting Records, Form Notices, Ballots, Proxies**

Another category of day to day documents that are important to obtain from the developer are the records associated with prior voting, amendments, or ballots. Voting and ballot information is essential because the Association is required to follow strict rules and regulations regarding voting. It should have a complete record of all prior voting and election by the members of the Association.



## **Service Contracts**

More than likely, the developer-controlled board hired various vendors and staff to conduct maintenance and repairs throughout the complex. It is important for the Association to have a complete record of repairs or maintenance done at the project, as well as copies of the service contracts with those vendors. The Association can review this information to determine whether it wants to continue using the developer's vendors or hire vendors of their own. Examples may include contracts for cable, elevators, laundry equipment and entry gates.

## **Disclosures to Owners re Pending Legal and Claim Matters**

Legal actions involving the Association can have an impact on its operations. If the developer-controlled board is participating in legal claims involving the Association, the newly elected board must learn the details of the action and obtain copies of all disclosures sent to the owners. And, any criminal activity reports should be reviewed and comprehended as the Association may be considered "on notice" of such activity even though the criminal activity or other wrongful conduct occurred before the homeowner board came into control of the Association.

## **Minutes and Resolutions Books (member, board, committees)**

As soon as the developer creates the Association, it needs to establish a board of directors. The developer will appoint members to be on the board, and they will have a first meeting in which a temporary chair and a temporary secretary will be elected. At the meeting, several organizational steps need to be taken, such as, setting up the Minute Book, reviewing the Articles of Incorporation and Bylaws, officially adopting the Bylaws, electing the officers (President, Vice President, Secretary, etc), and setting up a local depository for all funds received by the Association.

As set forth above, after the first organizational meeting, the board of directors may have special meetings or executive sessions

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in addition to the annual meeting. Board meeting minutes or board resolutions kept by the developer-controlled board should be handed over to the member-controlled board upon transition. Likewise, the decisions of committees with decision making authority and the architectural committee must be reflected in minutes and these should also be provided the homeowner board during the transition period. Thus, if these records are not produced as part of the provided Legal Documentation, they should be requested as Day-to-Day Operational Documents.

### **Pending Special Assessment Information**

An owner in a common interest development pays monthly assessments (sometimes called “dues”) or fees to the homeowners association to pay for insurance, exterior, and interior maintenance, water, sewer and garbage costs. Fees are first set by the developer-controlled board and can vary depending on many factors (such as whether the Association has a pool, fitness center, or door man). Some developers have an interest in keeping the monthly assessments artificially low to entice buyers to purchase a home. As a result, in many instances Association assessments are inadequate to cover the operating costs of the Association, so the assessments must be increased. Assessments are typically increased annually, but sometimes the board of directors must specially assess its members to cover costs of operations or for other purposes related to Association operations including inadequate reserves. Depending on the amount of these increases, membership approval may be needed for the new assessment levels.

# Chapter 7

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## Financial Documents

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Under Civil Code § 5300, the Association has an obligation to maintain various “financial documents” relating to the project and these are noted below. In order to properly maintain these records, the board should consider engaging professionals to assist, including certified public accountants, certified investment and tax advisors, licensed construction experts, and banking professionals.

Documents which must be maintained include these:

- Annual Budget Report;
- Bank and credit card statements;
- Invoices, receipts and canceled checks for payments made by the Association;
- General ledgers;
- Check registers;
- Budget comparison statements;
- Income and Expense statements;
- Investment statements;
- Balance Sheets;
- Summaries of the Association’s Reserves;
- Reports concerning any reserve deficiency expressed on a per home basis;
- Notices of Assessment Increase/Special Assessment;
- Statements concerning assessment collection and enforcement procedures;

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- Schedule of monetary penalties (fines);
  - Reports concerning the Association's outstanding loans;
  - Summaries of the Association's insurance program;
  - All prior annual disclosures distributed to the membership; and
  - State and Federal tax returns from the past seven years

### **Annual Budget Report**

The Budget is the financial road map for the Association. It sets forth the Association's planned revenue and planned expense. The Association must track and record revenue and expenses on an accrual basis. This means that revenue, such as member assessments, are recognized when earned and expenses are recognized when incurred.

### **General Ledgers and Check Registers**

General Ledgers and Check Registers show detail and provide backup for all of the association's payments and expense. The Association must keep accurate books showing all transactions occurring within various accounts over a specified period of time. Records of all checks issued from the Association's accounts must also be kept on file.

### **Budget Comparison Statements**

The Association must produce periodic comparisons between its budgeted expenditures and its actual expenditures. These statements will assist the Association and its financial consultants in forecasting future spending overruns or budget surplus.

# Chapter 8

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## Maintenance and Building Records

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The board of directors is responsible for ensuring that the Association's common assets are properly protected, preserved, and maintained. During the final transition process, the newly-elected board must make sure that the developer turns over to the Association and its property manager all of the manufacturers' maintenance manuals and the records for all maintenance work performed since the first owner-member closed escrow on her unit.

Typically, the property management company arranges for the actual maintenance functions using its employees and outside vendors. Generally, manufacturers will provide maintenance schedules and instructions. Those maintenance protocols should be implemented diligently because failure to do so could void the applicable manufacturers' warranties. Equally important, failure to implement the manufacturers' suggested maintenance protocols will significantly diminish the life expectancies of the building components and may jeopardize the quality of life and the investment value of the project.

The transition team must be proactive, rather than reactive, because preventing problems is often less expensive than repairing or replacing systems that have failed.

If neither the developer nor the manufacturer provide the Association with a maintenance protocol for a building component that is a common area asset, the board and the property manager should make a specific request for one or devise a maintenance protocol. This may require the transition team to retain professional contractors to assist in creating the protocol. The transition team should also augment whatever maintenance protocols it receives from the developer.

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The Association should request the following documents from the developer that will assist the newly-elected board and its property manager in achieving transition that preserves and enhances the Association's common areas.

- Inventory of Association's real and personal property (i.e., furniture, cleaning machines, keys, key FOBs, security software codes, etc.)
- Manufacturers' Building Component Warranties (i.e., HVAC system, elevators, windows, lift gates, exterior cladding, pool equipment, etc.)
- Manufacturers' recommended maintenance schedules and instructions
- List of original general & trade contractors
- Contact information for current vendors and service providers
- Building plans, specifications, engineers' reports and building permits
- Original construction documents, including bids, contracts, and lien releases
- Reports of building inspections by public building inspectors
- As-built plans
- Maintenance and repair records
- Expert reports assessing conditions of common areas during transition
- Locations of key components (water shut-off, irrigation valves, gas valves, emergency systems)

# Chapter 9

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## Miscellaneous Documents

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The following is a list of miscellaneous documents the newly-elected board should request from the developer prior to gaining control of the board.

- Annual Secretary of State Notices (identifying directors and officers)
- Lawsuit Settlements
- Lawsuit Records
- CID Registry
- Bonds
- Loan Documents
- Senior Age Housing Verifications
- Senior Housing Federal Compliance Certificates
- Master Leases and share certificates (Co-ops)

### **Annual Secretary of State Notices (Directors and Officers)**

Any document or notice received from the Secretary of State of California should be retained by the developer-controlled board and provided to the member-controlled board during transition.

### **Lawsuit Settlements and Records**

The Association should request from the developer all documents and records pertaining to any lawsuit in which the Association was a party and any resulting settlement.

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## CID Registry

The CID Registry of California™ has databases on approximately 39,000 Community Associations located in California's 58 counties (48 counties in Northern California and 10 counties in Southern California). The list is compiled from California corporate filings and in-house databases of management and other related entities. The database is formatted for easy import into virtually any data management program, and can help answer the following pertinent questions:

- What are the CIDs (HOAs, Condos, PUDs, etc.) in my business area?
- Who is the President of the Association?
- Who manages the Association?
- How do I contact the President or Manager?
- How old is the Association?
- Is the association's corporate filing status current?

The newly-elected board should have access to this very important tool and should check the registry periodically to make sure it contains the most current information about their Association.





## Bonds

A bond is a written guaranty or pledge which is purchased from a bonding company (usually an insurance company) to guarantee the performance of an obligation or the payment of a specified claim. The most common association bonds obtained by a developer is a “common area completion bond” to ensure the proper completion of construction of identified common area components (like fences, landscaping, the pool, clubhouse or roads) or an assessment payment bond (“payment bond”), or contract terms (“performance bond”). If the developer fails to complete the items listed on what is called the “Planned Construction Statement” (usually attached to the bond), the Association may submit a claim to the bond company to demand performance. Similarly, if the developer fails to pay assessments (up until the time 80% of the homes in the development are sold) the Association may demand that the bond company do so. It is essential that the homeowner directors on the board demand copies of the bond(s) and planned construction statement. The bonds have a *very short* statute of limitations and unless claims are timely made, it will be difficult or impossible to obtain recovery from the bond companies.

## Loan Documents

California law permits homeowner associations to borrow money and pledge assets (normally an Association’s income stream) to secure repayment. Sometimes this requires the approval of the membership but, depending on the requirements of the Association’s governing documents, it can also be done by board vote alone. In either case, if a loan has been obtained during the developer’s tenure on the board, the homeowner directors should obtain all loan documents. These documents are needed to enable the Association to make annually required disclosures about the amount, length and terms of the loan but the loan documents must be reviewed because they set forth important legal obligations that must be known to the owner directors.

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## **Senior Age Housing Verifications and Federal Compliance Certificates**

Generally speaking, it is against the law to discriminate in housing on the basis of age. Senior Housing developments enjoy an exception to this general rule. If the common interest development is a Senior Housing development – that is, a housing facility that is specifically designated for people over 55 years of age – it is entitled to an exemption from normal discrimination laws. To preserve the exemption, however, the Association must follow rules mandated by the Federal Fair Housing Act and related laws. For example, the community must comply with rules issued by the Secretary of Housing and Urban Development (HUD) for verification of occupancy. HUD requires the Association to provide verification by reliable surveys and affidavits that the residents meet the age restrictions. The Association also must include examples of the policies and procedures intended to limit residency to persons over a certain age.

The newly-elected board should make sure it is in compliance with the Federal Fair Housing Act and HUD and should request all verifications of occupancy and Federal compliance certificates issued by the government. If a Senior Housing development is not in compliance, it risks losing the ability to restrict who can live in the project. This loss could have significant legal, financial and political impacts on the community and so it should be avoided at all costs.

# Chapter 10

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## The Importance of the Audit

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We have stressed throughout this book the need for the member-controlled board to obtain and then review the documents and records received from the developer-controlled board during the transition process. Some of these documents will be very sophisticated and outside the realm of experience of those not specially trained. Thus, the homeowner board should also consult a third party or outside source to assist in auditing some of the records and reviewing the project for maintenance and construction issues. These two audits are called the “corporate” audit and the “construction and common area” audit.

### A. Corporate Audit

The corporate audit encompasses two distinct audits – the financial audit and the organizational audit.

- **Financial Audit**

When the developer created the Association, it had virtually unrestricted access to the Association’s funds. Though the developer and the developer’s board have an ethical obligation to the members to use the funds appropriately, this does not always occur. For example, if a common area component breaks, the cost to repair it could arguably come from Association’s funds (if the failure resulted from misuse) or paid by the Developer (if it was constructed improperly). When the developer-controlled Board “makes the call” and asserts the need for the fix arose from misuse, the member directors must be able to independently verify this contention. It is very important for the new member-controlled board to satisfy itself (and the other owners) that during the time the developer was in control of the board, all money received and all expenses paid were properly accounted for by the board. To

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assist the board in this task, it is highly recommended that the new board hire an independent auditor or certified accountant to inspect the Association's books and financial records. The types of documents that should be reviewed during the financial audit are:

- Financial Statements
- The Association's Pro Forma Operating Budget
- Bank Statements and Cancelled Checks
- Prior Reserve Studies

- **Organizational Audit**

The organizational audit will ensure that the newly-elected board can operate and manage the Association smoothly with the rules that were put in place by the developer. The most important documents to be audited (preferably by an experienced attorney) are the governing documents – the Articles of Incorporation, the Bylaws, and the CC&Rs. The newly-elected board must determine whether the rules and regulations set forth in the governing documents will work for the Association. As fiduciaries, they are in charge of enforcing those rules, and therefore must fully comprehend and support them.

## **B. Construction and Common Area Audit**

The newly elected board should also retain the services of a professionally licensed architect or engineer to conduct an inspection of the property. The inspection should consist of a thorough review of all major systems, including the roofs, siding, foundations, electrical systems, plumbing, and landscaping and drainage, as maintenance of these common areas is the responsibility of the Association. The consultants' services should include a review of the physical condition of the property, the recommended repairs to be performed (if any), the recommended maintenance schedule, and a confirmation that all components listed above are built according to the building code.

Another very important (and often overlooked) aspect to the construction audit is for the newly-elected board's legal counsel to review the documents and confirm that the Association actually does own all the common areas. This may sound like a silly proposition, however, in the business of construction and transfer/sale of real estate, it is entirely possible for a document to be misplaced, overlooked, misinterpreted, etc. Therefore, it is the board's responsibility to ensure that the recorded documents are correct, and that the Association does, in fact, own all the common areas of the project.

And, as set forth in Chapter 13, there are new, shorter statutes of repose that apply to the work in constructing a community association. Unlike a statute of limitation that starts the clock running for timely bringing a claim when damage has occurred, these statutes of repose start when the community construction is substantially complete and the governing documents say that a homeowner can start the process. The time periods for bringing a claim or forever being barred from bringing one are as short as 1 year, so having a construction audit can never be said to be premature even when damage has not yet occurred.





# Chapter 11

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## Reserves and Reserve Studies

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Civil Code §§ 5500 - 5560 set forth the duties of a community association's board of directors with regard to reserves and reserve studies.

When homeowners pay assessments, they are funding both current operational needs and reserves. Reserves are funds set aside to finance long term replacement of Association owned or maintained components that have a limited useful life. The Association creates reserves to fund its future financial needs, including capital improvements to replace failing building components.

Civil Code § 4177 defines a reserve account as “[m]oneys that the association's board of directors has identified for use to defray the future repair or replacement of, or additions to, those major components that the association is obligated to maintain.”

By statute, the board is required to obtain a new reserve study for all major components that comprise the common assets of the Association at least once every three (3) years. It must also conduct an annual review of the existing study to determine if it should be adjusted based on the experiences of the Association in the previous fiscal year. There are two primary reasons for conducting a reserve study. First, a reserve study is needed to ascertain the current state of the Association's financial position. Second, a reserve study helps determine whether the Association has reserved sufficient funds to pay for long-term maintenance of the common assets and for replacement of worn out equipment and building components that are part of the Association's common assets.

All building components, especially mechanical components like elevators, the HVAC system, and garage gates, require periodic

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maintenance, occasional repairs, and replacement at the end of their useful lives. An Association generally has a legal duty to ensure that the Association has sufficient funds to maintain, repair, restore and replace major components that comprise the common assets, when the needs arise.

Most boards discharge this crucial duty by reserving sufficient funds through careful budgeting and consulting with accountants, investment advisors and construction experts, to prepare for contingencies that are certain to materialize. This approach, which is commonly referred to as the “straight line” method, comports with best practices. The straight-line method is discussed below.

An alternative to reserving funds for these inevitable contingencies is to wait for the contingency to materialize and then levy a (typically sizable) special assessment against each owner to raise sufficient funds to deal with the contingency. This approach is commonly referred to as the “cash flow” method. While it may work for a community association whose members are financially capable of writing checks to cover big expenses (\$25,000 per member to replace the roof, for example), most Associations will find the “cash flow” method impractical or unworkable.

Generally, the better approach is the straight line method; that is, to set up a reserve account, collect funds from the members through monthly assessments and deposit the “extra” funds in a reserve account. The amount of the monthly assessment should be based on an analysis of the useful life of each component and the estimated cost for maintaining, repairing and/or replacing that component.

The board should hire a team of professionals to conduct an adequate reserve study. Every reserve study requires two sets of professionals who must work together to produce a final product. First, the board should hire construction experts to evaluate the remaining life of each major component and estimate the cost for performing the necessary work on that component. Second, the board should hire financial experts to ascertain the Association’s current financial position and then determine a feasible funding





program based on the construction experts' estimated costs for maintaining, repairing or replacing all of the major components.

During the transition phase, the owner-controlled board should seriously consider commissioning a reserve study to ensure that the reserve account which the developer created has sufficient funds. The sufficiency of the reserve account will depend largely upon the soundness of the assumptions made by the developer and its consultants about the useful life expectancy of each of the major components (assumptions made before these components are even constructed). Some components may need to be replaced sooner if actual usage far exceeds the projected usage. The developer may have underestimated the actual usage during the development stage, especially if the project ends up attracting a different mix of buyers than the original market analysis that formed the basis for the initial reserve study.

The most reliable way for the owner-controlled board to confirm the soundness of the developer's usage, life expectancy, and cost assumptions is to hire professionals to perform an independent analysis of those assumptions. If the reserve study reveals inadequacies, the owner-controlled board can work with the developer to resolve the shortages. To resolve any shortages, the owner-controlled board may also consider hiring an attorney to work with the developer to find a solution satisfactory to all.



# Chapter 12

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## Insurance

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Insurance provides important risk protection to community associations. A community association's longevity and financial health depend upon transferring the same risks that any corporation confronts. Those financial risks can include potential damage to the Association's common physical assets caused by fire or severe winter storms, the depletion of the Association's financial assets through embezzlement, or defending the Association against lawsuits.

Most governing documents require an Association to maintain specified types and sometimes specified levels of insurance. We have listed some examples below. New member directors do not have to understand all the nuances of coverage but should be generally familiar with the kinds of policies required and what they cover (and don't cover). Here are some examples:

**1. Property and Casualty Insurance Policy:**

This type of policy protects against physical damage to the Association's tangible common assets. These generally include the building's core, shell, envelope, roofs, mechanical, electrical and plumbing systems.

**2. General Commercial Liability ("CGL") Policy:**

This policy protects the Association against lawsuits brought by anyone seeking damages to their property and/or person. On a practical level, a CGL policy affords premises-liability coverage to the Association. For example, if a guest's vehicle is damaged by a fallen tree owned by the Association while the vehicle is on the Association's property and the driver also sustained

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bodily injuries during this accident, the CGL policy will defend the Association and pay the guest's damages. Typically, a CGL policy contains the following insuring clause: We will pay those sums that the insured becomes legally obligated to pay as damages because of 'bodily injury' or 'property damage' to which this insurance applies. We will have the right and duty to defend the insured against any suit seeking those damages.

Under Civil Code § 5805, an Association comprised of 100 or fewer separate interests is required to obtain a policy limit of at least two million dollars (\$2,000,000) in order for its directors to obtain qualified immunity from claims. If the Association is comprised of more than 100 owner-members, the minimum required policy limit for this qualified immunity is three million dollars (\$3,000,000).

### **3. Directors & Officers ("D&O") and Company Policy:**

This policy protects the Association's board of directors and the association against lawsuits alleging wrongful acts committed by them in their official capacity on behalf of the Association. It is advisable to purchase the "employment practices" coverage which is available as an option coverage under the D&O policy because this covers the directors, officers, other employees and the Association from claims based on alleged unlawful employment practices against workers the Association may directly employ.

Under Civil Code § 5800, an Association comprised of 100 or fewer separate interests is required to obtain a policy limit of at least five hundred thousand dollars (\$500,000) in order for its directors to obtain qualified immunity from claims. If the Association is comprised of more than 100 owner-members, the minimum required policy limit is one million dollar (\$1,000,000).

#### **4. Fidelity Bond:**

A fidelity bond protects the Association's financial security against losses caused by embezzlement. Even with tight financial controls, there is always a chance that the Association's funds could still be stolen by persons entrusted to handle them. Losing funds to embezzlement could prevent the Association from paying its bills, funding reserves, and satisfying other crucial financial obligations. A fidelity bond is intended to cover those expenses. The bond's limit should be commensurate with the sum of the values of the Association's liquid assets, including savings, checking and certificate of deposit accounts. While such a bond is not necessary to preserve the volunteer director's immunity from personal liability, it is prudent for the new homeowner-controlled board to consider for the Association's protection.

#### **5. Earthquake Insurance:**

This type of insurance protects against property damage caused by earthquakes. In the aftermath of the 1994 Northridge earthquake, premiums for earthquake insurance skyrocketed. However, earthquake insurance premiums have eased some in recent years. Most of the CC&R's written by developers do *not* require the Association to obtain earthquake insurance and board members are generally protected from personal liability even if the Association does not have this coverage. However, the membership could amend the CC&R's to require the board to purchase earthquake insurance to protect the Association's common assets if it was so desired.

In considering any of these insurance policies, the board should consult a knowledgeable insurance broker to ensure that the Association obtains sufficient insurance protection for all of its financial risks. The Association's insurance program must be

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managed with the same prudence as its financial and physical assets because insurance coverage is an indispensable risk-allocation tool to protect those financial and physical assets. An insurance broker will help the board secure the proper mix of insurance coverage at the best price. We strongly recommend that the broker be experienced in working with associations and that the broker be provided with the governing documents (that specify insurance requirements) and any contracts (like the management contract) that may require the Association to name under its policies third parties as additional insureds to the Association's insurance policies.

# Chapter 13

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## Time Limits For Bringing Construction Defect Claims

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During or after the transition process, the Association's board may become aware of construction defects; buildings may leak through windows, plumbing, decks or roofs; mechanical systems may not properly heat or cool; components may be poorly assembled; water may not properly drain; landslides may occur or any number of other problems may ensue. The number of developments plagued by defects – and the number of claims brought to seek redress – was so high that the legislature enacted a series of laws to help resolve them.

These laws are mostly contained in Civil Code §§ 895 through 945.5 (known as “Title 7” or “SB 800”) which generally applies to homes sold on or after January 1, 2003.

The construction industry lobbied for Title 7 in order to permit the builders/developers the right to “fix” construction deficiencies and avoid litigation. Since they sponsored the law, one would think the developer/builders would have taken full advantage of their right to fix defects (the statutory scheme is sometimes referred to as the “Right to Repair Law”) but they haven't. The laws –especially the time frames required for notices and action – are very complicated and at this stage of the process not advantageous for homeowner associations. Without guidance of professionals – attorneys, construction experts and others –the laws are titled against obtaining a resolution favorable for the association except for claims involving insignificant sums.

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Under Title 7, an Association **must** pursue its construction defect claims within certain timeframes (“statutes of limitations”) or else the Association’s legal rights to pursue those claims will expire and forever be barred, meaning, that the Association itself will have to pay to correct whatever defects exist. Each building component has its own statute of limitations and they range from 1 to 10 years. The “trigger” for when the statutes of limitations begin to run may depend on provisions of the governing documents, sales dates, completion of the project or when the developer relinquished control of the board. The calculation of when a statute of limitations (or statutes of “repose” which are similar) begins to run or expires should *never* be determined by anyone other than competent counsel.

For purposes of Title 7, each applicable statute of limitation begins to run as soon as the builder / developer relinquishes control of the Association to the owners. The association, through its owner-controlled board, must act prudently to adequately protect the interests of the Association during the transition. One thing that is clear is that the limitations periods are surprisingly short; here are some illustrations under the applicable Civil Code (CC) sections:

- One (1) year for Acoustical Problems (Excessive Noise Transmissions) [CC § 896(g)(6)];
- One (1) year for Irrigation and Drainage Systems [CC § 896(g)(7)];
- Two (2) years for Wood Posts Decay [CC § 896(g)(8)];
- Two (2) years for Landscaping [CC § 896(g)(12)];
- Two (2) years for Dryer Ducts [CC § 896(g)(14)];
- Four (4) years for Plumbing and Sewer Systems [CC § 896(e)];
- Four (4) years for Electrical Systems [CC § 896(f)];



- Four (4) years for Excessive Cracking in Decks, Pathways, Walkways, Driveways, Sidewalks, and Patios [CC § 896(g)(1)];
- Four (4) years for Corrosion of Steel Fences CC § 896(g)(9);
- Five (5) years for Painting and Staining [CC § 896(g)(10)];
- For all components *not* listed above, the limitations period is the shorter of three years of when a defect was or should have been discovered or ten (10) years from substantial completion or recordation of valid notice(s) of completion [CC § 941(a)].

The owner-controlled board will probably have failed in its fiduciary duties if it does not promptly notify the developer in writing of significant Title 7 claims. More than that, putting a developer on notice initiates a process that, if successfully concluded, will garner for the Association enough money to fix the defects without undue burden on the members. This process may include commencement of litigation, negotiation and in rare cases pursuing arbitration or trial.





# Chapter 14

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## Mixed-Use Common Interest Developments

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A typical mixed-use development consists of commercial spaces on the ground and lower floors with residential condominiums on the upper floors. This trend is most visible and is expected to continue in major Bay Area cities like San Francisco, Oakland, Emeryville, Palo Alto and San Jose.

Smaller mixed-used developments tend to have a single owner association that governs both the residential and commercial communities. Larger mixed-units developments may have multiple associations. For example, there could be a master owner association that governs the entire development and a separate sub-association that governs the residential units and another sub-association that governs the commercial spaces. Each association will operate under its own governing documents. The master owner association will typically own the common assets of the entire mixed-use development, such as the HVAC systems, elevators, parking structures and roofs, which serve both the residences and the commercial spaces. In other mixed use developments, the resident and commercial associations will have separate boards and overlapping easements or CC&Rs. It is essential that in any mixed use project, the governing documents – which tend to be more complicated than in a residential project – should be thoroughly understood, especially, in relation to maintenance, insurance and cost sharing.

In any event, all of the matters covered in these Chapters apply equally to mixed-use common interest developments. Coordination and sharing of information between the different associations – master, commercial and/or residential – is the hallmark of good relations and the foundation for a strong community.



# Chapter 15

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## Keys to A Successful Transition: The Three “C’s”

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Transition can be a complicated, lengthy and sometimes contentious process, but many problems can be avoided if the developer-controlled board and the homeowner members follow the three “C’s” – that is, Communication, Careful Review, and Competent Counsel.

### (1) COMMUNICATION

Effective communication is one of the most important keys to a successful transition. But, in order to be effective, the communication must begin long before the transition period ever begins.

Communication must start with the developer and the developer-controlled board as soon as the board is formed. The developer-controlled board should communicate with the owners so the developer understands the wants and needs of the members of the community.

Real communication during this time also allows the owners to develop trust and respect for the developer, which facilitates resolution of any problems that may arise later.

One of the most effective ways to ensure communication between the members and the developer-controlled board is through the creation of an advisory committee comprised of members of the association. The purpose of the advisory committee is to act as a liaison between the members and the developer-controlled board, making recommendations to the board based on the wants and needs of the members. Homeowners often feel helpless in attempting to resolve a problem with their unit or the common areas all by themselves, and often will wait until an

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annual meeting or a situation where there are several homeowners gathered together before speaking up. To ease the homeowner's fears, the advisory committee can serve to relay information from the individual homeowners to the developer. Although the advisory committee has no real authority, it can still have tremendous influence over the community members' feelings and trust of the developer.

Another way to facilitate communication between the developer and the members is for the developer to educate the members about the concept of common interest developments and community living. The developer should provide written information and hold regular sessions with the members to review the governing documents and other community rules and regulations, review the budget, and answer any questions the members of the association may have. Developers are regularly using websites to advertise their properties and they could easily include a portal for new owners to learn more about their community. If members of the association are educated at the outset about their rights and responsibilities, when it is time for the members to gain control of the board, the members will be confident and comfortable governing their association.

The developer should also incorporate board training from the moment the developer-controlled board is elected. The newly appointed board members should be educated as to the duties owed to both the association and the owners, and to the fact that they now owe a fiduciary duty to the association. Similarly, during the transition process, the developer and developer-controlled board should educate the owner-elected board members as to their duties and responsibilities. Knowledgeable board members who understand the duty they owe to the members are more likely to act in a manner that serves the association's best interests.

A community association will be successful if the developer and members communicate openly and honestly. Effective communication by the developer-controlled board at the outset fosters an amicable and smooth transition period, and instills trust of the developer by the members.

## **(2) CAREFUL REVIEW**

Another important aspect of the transition process is careful review and identification of all the relevant documents. Among the most important documents to locate and carefully review are: the complete set of governing documents (including the Covenants, Conditions and Restrictions, meeting minutes, master deed, board resolutions, etc.), marketing materials (brochures, ads, and handouts), contracts (leases, written warranties, and contract with the management company), financial documents (reserves, budgets, and tax information), and all other association correspondence.

During the transition period, the member-elected board members should be sure to not only request all relevant documents from the developer, but to carefully review those documents and make changes if necessary. This task should not be completely delegated to the manager. Once educated, the board will be able to responsibly deal with the developer and transition issues that arise.

## **(3) COMPETENT COUNSEL**

The complexity of the developer-drafted governing documents and the Davis-Stirling Common Interest Development Act (and its constant evolution) mandate that an association engage experienced counsel for advice and representation. Competent legal representation of a community association is essential for the smooth transition from a developer-controlled board to a member-controlled board. The developer's attorney assists in drafting the governing documents, sales documents, and in the development and construction of the project. It is important for the developer's attorney to realize that many states have rules and regulations regarding the transition process. Therefore, the governing documents created by the developer should be drafted so they comply with state and local laws and so they develop a reasonable turnover schedule.

Although the developer's attorney is involved in many aspects of the development and construction of the project, the community association should be represented by its own counsel,

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so as to avoid a conflict of interest. In fact, many states forbid an attorney from representing both the developer and the association.

To avoid a conflict, as soon as practicable after assuming control of the association, the member-controlled board should retain its own independent legal counsel. The board should diligently research the attorneys in their area, and find one with experience in community associations, management, and the transition process. Specifically, the attorney should have the knowledge and experience to review and revise (if necessary) the CC&Rs, identify the potential claims, including those involving construction deficiencies, that need to be investigated, identify the potential parties against whom the claims can be asserted, and determine what statutory limitations apply to each of the potential claims. In its review of the governing documents, the attorney should ensure that the documents aren't too rigid and difficult to amend in the future. The documents should be carefully crafted and customized to reflect the unique needs of the community association's members.

Sticking to the three "C's" will make your job as a director much easier, and ensure to you and the Association a smooth and proper transition that will last a "community" lifetime!



# Glossary of Terms

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## Non-Legal Terms

(1) **Developer-Controlled Board**

When an association is first formed by the developer, it is controlled by the association. The board of directors typically consists of the developer and other individuals professionally related to the developer, and is responsible for managing the affairs of the association including not only the physical attributes, but also the financial and administrative issues such as collecting owner assessments, holding the annual meeting, and enforcing the deed restrictions.

(2) **Owner-Controlled Board**

During the transition process, the developer and its representatives will turn over control of the board to the members of the association. The “owner-controlled” board takes over the responsibilities of managing the affairs of the association.

(3) **Mixed-Use Development**

A mixed use development is one that is comprised of residential and commercial units.

## Legal Terms

Since common interest development associations are legal entities created under the Davis-Stirling Common Interest Development Act, as codified in California Civil Code sections 4000 through 6000, it is imperative to know some of the terms defined in sections 4075 through 4190.

- (a) **“Association”** means a nonprofit corporation or unincorporated association created for the purpose of managing a common interest development.

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- (b) **“Common area”** means the entire common interest development except the separate interests therein.
- (c) **“Common interest development”** means any of the following:
- (1) A community apartment project.
  - (2) A condominium project.
  - (3) A planned development.
  - (4) A stock cooperative.
- (d) **“Community apartment project”** means a development in which an undivided interest in land is coupled with the right of exclusive occupancy of any apartment located thereon.
- (e) **“Condominium plan”** means a plan consisting of:
- (1) a description or survey map of a condominium project, which shall refer to or show monumentation on the ground,
  - (2) a three-dimensional description of a condominium project, one or more dimensions of which may extend for an indefinite distance upwards or downwards, in sufficient detail to identify the common areas and each separate interest, and
  - (3) a certificate consenting to the recordation of the condominium plan pursuant to this title signed and acknowledged by the following:
    - (A) The record owner of fee title to that property included in the condominium project.
    - (B) In the case of a condominium project which will terminate upon the termination of an estate for years, the certificate shall be signed and acknowledged by all lessors and lessees of the estate for years.
    - (C) In the case of a condominium project subject to a life estate, the certificate shall be signed and acknowledged by all life tenants and remainder interests.

- (D) The certificate shall also be signed and acknowledged by either the trustee or the beneficiary of each recorded deed of trust, and the mortgagee of each recorded mortgage encumbering the property.

Owners of mineral rights, easements, rights-of-way, and other nonpossessory interests do not need to sign the condominium plan. Further, in the event a conversion to condominiums of a community apartment project or stock cooperative has been approved by the required number of owners, trustees, beneficiaries, and mortgagees pursuant to Section 66452.10 of the Government Code, the certificate need only be signed by those owners, trustees, beneficiaries, and mortgagees approving the conversion.

A condominium plan may be amended or revoked by a subsequently acknowledged recorded instrument executed by all the persons whose signatures would be required pursuant to this subdivision.

- (f) A **“condominium project”** means a development consisting of condominiums. A condominium consists of an undivided interest in common in a portion of real property coupled with a separate interest in space called a unit, the boundaries of which are described on a recorded final map, parcel map, or condominium plan in sufficient detail to locate all boundaries thereof. The area within these boundaries may be filled with air, earth, or water, or any combination thereof, and need not be physically attached to land except by easements for access and, if necessary, support. The description of the unit may refer to (1) boundaries described in the recorded final map, parcel map, or condominium plan, (2) physical boundaries, either in existence, or to be constructed, such as walls, floors, and ceilings of a structure or any portion thereof, (3) an entire structure containing one or more units, or (4) any combination thereof.

The portion or portions of the real property held in undivided interest may be all of the real property, except for the separate

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interests, or may include a particular three-dimensional portion thereof, the boundaries of which are described on a recorded final map, parcel map, or condominium plan. The area within these boundaries may be filled with air, earth, or water, or any combination thereof, and need not be physically attached to land except by easements for access and, if necessary, support. An individual condominium within a condominium project may include, in addition, a separate interest in other portions of the real property.

- (g) **“Declarant”** means the person or group of persons designated in the declaration as declarant, or if no declarant is designated, the person or group of persons who sign the original declaration or who succeed to special rights, preferences, or privileges designated in the declaration as belonging to the signator of the original declaration.
- (h) **“Declaration”** means the document, however denominated, which contains the information required by Section 1353.
- (i) **“Exclusive use common area”** means a portion of the common areas designated by the declaration for the exclusive use of one or more, but fewer than all, of the owners of the separate interests and which is or will be appurtenant to the separate interest or interests.
  - (1) Unless the declaration otherwise provides, any shutters, awnings, window boxes, doorsteps, stoops, porches, balconies, patios, exterior doors, doorframes, and hardware incident thereto, screens and windows or other fixtures designed to serve a single separate interest, but located outside the boundaries of the separate interest, are exclusive use common areas allocated exclusively to that separate interest.
  - (2) Notwithstanding the provisions of the declaration, internal and external telephone wiring designed to serve a single separate interest, but located outside the boundaries of the separate interest, are exclusive use common areas allocated exclusively to that separate interest.

- (j) **“Governing documents”** means the declaration and any other documents, such as bylaws, operating rules of the association, articles of incorporation, or articles of association, which govern the operation of the common interest development or association.
- (k) **“Planned development”** means a development (other than a community apartment project, a condominium project, or a stock cooperative) having either or both of the following features:
- (1) The common area is owned either by an association or in common by the owners of the separate interests who possess appurtenant rights to the beneficial use and enjoyment of the common area.
  - (2) A power exists in the association to enforce an obligation of an owner of a separate interest with respect to the beneficial use and enjoyment of the common area by means of an assessment which may become a lien upon the separate interests in accordance with Section 1367 or 1367.1.
- (l) **“Separate interest”** has the following meanings:
- (1) In a community apartment project, “separate interest” means the exclusive right to occupy an apartment, as specified in subdivision (d), above.
  - (2) In a condominium project, “separate interest” means an individual unit, as specified in subdivision (f), above.
  - (3) In a planned development, “separate interest” means a separately owned lot, parcel, area, or space.
  - (4) In a stock cooperative, “separate interest” means the exclusive right to occupy a portion of the real property, as specified in subdivision (m), below.

Unless the declaration or condominium plan, if any exists, otherwise provides, if walls, floors, or ceilings are designated as boundaries of a separate interest, the interior surfaces of

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the perimeter walls, floors, ceilings, windows, doors, and outlets located within the separate interest are part of the separate interest and any other portions of the walls, floors, or ceilings are part of the common areas.

The estate in a separate interest may be a fee, a life estate, an estate for years, or any combination of the foregoing.

- (m) **“Stock cooperative”** means a development in which a corporation is formed or availed of, primarily for the purpose of holding title to, either in fee simple or for a term of years, improved real property, and all or substantially all of the shareholders of the corporation receive a right of exclusive occupancy in a portion of the real property, title to which is held by the corporation. The owners’ interest in the corporation, whether evidenced by a share of stock, a certificate of membership, or otherwise, shall be deemed to be an interest in a common interest development and a real estate development for purposes of subdivision (f) of Section 25100 of the Corporations Code.

A “stock cooperative” includes a limited equity housing cooperative which is a stock cooperative that meets the criteria of Section 33007.5 of the Health and Safety Code.

## COMMUNITY ASSOCIATION MANAGEMENT COMPANY TRANSITION CHECKLIST

The transition of records from a developer-controlled board to a member-controlled board requires clarity, timeliness and mutual respect between the parties. The documentation of records transferred serves the interest of the Association and its members as well as the “new” and the “prior” management companies since doing so can eliminate future disputes and expense. Below are listed documents that are among those typically transferred. There may be other documents unique to each community that should also be transferred, so each Association should consult with their attorney.

### I. LEGAL DOCUMENTS

*(including original and amended versions)*

Document Type	Date Requested	Date Received	Document Location
Recorded CC&Rs, Condominium Plans, Easements, “Special Agreements”			
Recorded or Filed Maps and Deeds, Development Agreements			
DRE Public Reports and Budgets			
Declarations of Annexation			
Filed Articles of Incorporation			
Bylaws			
Rules			
Policies mandated by Davis-Stirling Common Interest Development Act			
Architectural Approval Request Forms and Forms Granting/ Denying Requests			
CC&R Violation Letters			
Notices of Violation (for use in escrow as permitted by law)			
Legal Options			

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## II. MISCELANEOUS DOCUMENTS

<b>Document Type</b>	<b>Date Requested</b>	<b>Date Received</b>	<b>Document Location</b>
Annual Secretary of State Notices (directors and officers)			
Law Suit Settlements			
Law Suit Records			
CID Registry			
Bonds			
Loan Documents			
Senior Age Housing Verifications			
Senior Housing Age Verifications (original to current)			
Senior Housing Federal Compliance Certificates			
Master Leases and share certificates (Co-ops)			



### III. FINANCIAL DOCUMENTS

<b>Document Type</b>	<b>Date Requested</b>	<b>Date Received</b>	<b>Document Location</b>
Budget and Back Up Worksheets			
Reserve Studies			
Balance Sheets, Ledgers, Bank Statements, Bills, Income Statements			
Cancelled Checks (2 years)			
Accounts Receivable, Account Payable			
Record of Assessment Collection			
Activities, Pending Foreclosures			
Tax Returns (7 years), Tax ID Number			
Evidence of Tax Exempt Status			

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#### IV. MAINTENANCE AND BUILDING RECORDS

Document Type	Date Requested	Date Received	Document Location
Inventory of Association Real and Personal Property			
Warranties			
List of Original Contractors			
List of Current Vendors and Service Providers			
Building Plans and Specifications			
Operating & Maintenance Manuals			
Expert Reports re Building/Site Conditions			
Owner Maintenance Questionnaires			
Locations of Key Building Components (water shut-off/irrigation valves; sewer cleanouts)			
City or Other Agency Approvals (OSHA, etc.)			

## V. DAY TO DAY RECORDS

Document Type	Date Requested	Date Received	Document Location
List of Member's Names and Contact Information and Emergency Contacts (Mailing Addresses, Telephone Numbers & E-Mail Addresses)			
List of Owner "opt-outs" of Membership Directory Contact Information			
Parking and Parking Sticker Information (Vehicle Type and License Numbers)			
Voting Records, Form Notices, Ballots, Proxies			
Service Contracts			
Insurance Policies			
Pending Insurance Claims			
Disclosures to Owners re Pending Legal and Claim Matters			
Newsletters			
Keys			
Minutes and Resolutions Books (member, board, committees)			
Unit/Lot File			
Open Escrows			
Pending Special Assessment Information			
Management Reports and Agendas			



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## Complimentary Homeowner Association Document Review and Defect Investigation

**PROBLEM** The directors of many newer associations have concerns about the condition of their project and specifically want to know what responsibility they have to investigate suspected problems and whether they have claims which might expire.

**SOLUTION** Berding|Weil will do a quick, **no-cost** investigation of potential construction claims using acknowledged experts in their field. We will research and review necessary documents and advise the board of statutes of limitation that might interfere with their potential recovery.

- WE WILL**
1. **Meet with the board of directors** and discuss information already known about potential construction problems.
  2. **Review the association's governing documents and maintenance manuals** to identify the association's repair responsibilities; dispute resolution requirements; and possible triggers for statutes of limitation.
  3. **Review the association's key maintenance and repair records** for indications of abnormal construction issues.
  4. **Prepare a questionnaire** to the individual owners if necessary to accumulate further information on suspected construction problems.
  5. **Retain an expert** — architects or engineers — appropriate for the problems indicated by our discussions with the board and the members and our review of the documents, and coordinate a preliminary inspection by one of these experts.
  6. **Meet a second time with the board** and the expert(s) to discuss the findings of our review and the expert opinion on potential problems. Provide the board with our recommendation of the best approach for resolution of the problem with the builder and to protect the association from the expiration of claims. If claims are identified, we will also:
  7. **Prepare and send the necessary notice** under the California Civil Code to suspend statutes of limitation on claims that might otherwise expire.

**BERDING|WEIL** will undertake this investigation, retention of experts and review **without cost** to the association. Depending upon the amount and availability of the material necessary for the review, these investigations can usually be completed in three to four weeks from the time of the first meeting with the board.

If we can help your association, email [complimentary@berding-weil.com](mailto:complimentary@berding-weil.com) or contact Berding|Weil at 925-838-2090 and we will schedule a meeting with your board of directors.

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## Reconstruction Project and Hidden Damage Legal Services For Older Community Associations

**PROBLEM** The directors of many older associations have concerns about the condition of their project and specifically want to know: what legal responsibility the association has for certain maintenance or repair problems; if there is hidden damage to the project that may be undetected, and if so, does the association have the financial resources necessary to deal with both the known as well as any unknown problems; if not, what options are available to the association; and how BerdingWeil can assist.

**SOLUTION** BerdingWeil will do a quick assessment of a potential re-construction project using acknowledged experts in their field. We will review the association's bids and available financial resources; review your governing documents; and advise the board of any legal requirements for raising the necessary funding for the project such as obtaining member authority for assessments or bank loans. **We will do this all for a single flat fee.** We are leaders in construction law and construction failures and will assist the association in dealing with big and unexpected re-construction projects and their consequences.

- WE WILL**
1. **Meet with the board of directors** and management **at no charge** and discuss information already known about potential re-construction projects or suspected problems. After that meeting we will provide a proposal to do the following for a single **flat fee**.
  2. **Review the association's governing documents and maintenance manuals** to identify the association's **repair responsibilities**; member authority necessary for extraordinary funding such as **assessments or bank loans**.
  3. **Review the association's key maintenance and repair records** for any history of **abnormal or hidden construction issues**.
  4. **Prepare a questionnaire** to be given to the **individual owners** to accumulate further information on suspected, unknown or hidden construction problems.
  5. **Coordinate the retention of an appropriate expert** — architect or engineer —for the problems indicated by our discussions with the board, our review of the documents, and coordinate a **preliminary investigation** of the problem by this expert to assess the **scope and utility** of re-construction and to begin the process of determining what **funding** will be necessary. The initial services of the expert are included in the flat fee.
  6. **Meet a second time with the board and the expert** to discuss the findings of our review and the expert's opinion on the **scope of the potential reconstruction project**. We will also provide proposals as necessary for drafting construction documents; coordination of funding—special assessments or bank loans; and for general legal oversight for the project.

If we can help your association, email [complimentary@berding-weil.com](mailto:complimentary@berding-weil.com) or contact BerdingWeil at **925-838-2090** and we will schedule a meeting with your board of directors.



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