BERDING | WEIL's

GUIDE TO COMMUNITY ASSOCIATION TRANSITION

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

ABOUT

BERDING | WEIL

BERDING & WEIL LLP provides experienced, comprehensive, and practical legal counsel to community associations throughout California and Hawai'i. 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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Board members, property management professionals, developers, educators, attorneys and others working in common area development fields who would like to receive *Guide to Community Association Transition* in quantity for distribution to staff, association members, clients, students, etc., should contact us to discuss their requirements. We shall do our best to fill all requests. Delivery is subject to inventory. You may obtain additional copies by contacting us at the addresses and phone number above.

Berding & Weil is a law firm founded in 1988. Its practice includes Construction Law, Defect Litigation, Common Interest Developments, Commercial Real Estate and Business Law that represents building owners, community associations, corporations, commercial real estate owners and businesses throughout California. Berding & Weil has a strong interest in the welfare of our clients and offers legal services and competitive fees tailored to their needs.

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INTRODUCTION

Over more than three decades, we have assisted thousands of directors to manage community associations. Serving on a board is difficult; the challenges are great, especially during the early life of the association. The developer representatives on the board often 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 only join the Board after the developer appointees have been in power, and homeowner directors typically have little experience serving on a board and no political power to do things 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 easy to maintain, 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 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 book was written to help homeowner directors successfully navigate a 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 reading the right documents and getting timely expert advice on such things as finances and maintenance.

While based on our experiences representing community associations during all stages of a community's development, the information and legal analysis provided here are general. The legal, political, and financial issues faced by each new board and each community will vary based on their governing documents, the cooperation of the developer, the support of the members, and many other considerations. Our book is a beginning and will provide the directors with the help they need in serving their community.

Chapter 1

WHAT IS COMMUNITY ASSOCIATION TRANSITION?

Transition 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 events taking place over months or, sometimes, years. Transition reflects the period when the developer conveys control of a multi-million-dollar real estate project to the owners. When the transition has ended, the member-elected board of directors, usually assisted by a community manager, becomes responsible for the management and preservation of assets worth millions of dollars and for the hopes and dreams of homeowners, often first-time buyers. A smooth transition makes sure the operation gets off on the right foot.

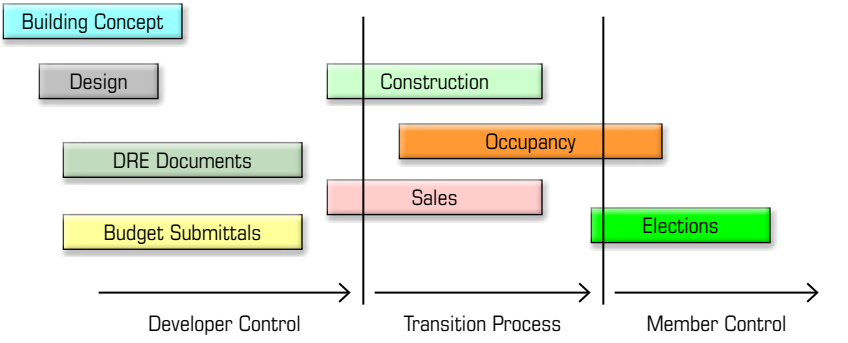
When a community association is developed, the developer devotes a lot of time and resources to constructing its project and sales of homes and condominiums (referred to here for convenience as "homes"). The developer will obtain land, engage design professionals and contractors and obtain government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

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 the direction of the community during the transition period. The developer appoints representatives to serve on the board; it controls the votes (having three 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 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 governance by the owners. A wise developer educates owners about the association and keeps up this effort during the entire transition process. This way, when the developer leaves the project and control passes to the member-controlled board, the association's operations move forward smoothly.

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

- The developer provides the association with all pertinent information, such as governing documents, financial records, 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 ambiguous issues about 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 operations and sufficient to finance the long-term replacement of components.



Chapter 2

TRANSITION TEAM MEMBERS AND THEIR ROLES

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 community manager, and in many cases, a new community manager.

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 available to help the owners and the present community manager with this final yet very critical phase. Some developers are more adept than others at helping the transition team to help realize its goal of getting the newly appointed owner-controlled board off on solid footing as it embarks on self-governance.

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, 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 committees comprised of some members of the board) will perform which tasks. A balanced division of labor will lead to the best result. Tasks during this period might include verification that all documents have been received (including the existing community management contract), reaching an understanding of what they say, reviewing the common areas being "turned over,"; and communication 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 community manager selected by the developer. If the new board decides to replace the existing manager, the board members must conduct an active search for a replacement and adequately investigate each candidate. If the board hires a new community manager, the board members must try to ensure the old manager cooperates with the new manager and helps to educate him or her about the project and the association.

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

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

The Original Community Manager

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

Community managers are critical to the well-being of an association because they are responsible for several different aspects of an association. For example, they help 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 community manager was present from the first sales of the units, the newly appointed owner-controlled board will rely heavily upon their knowledge during the transition process. The community 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 often meet with the original community 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 community 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 regarding repairing outstanding punch list items and damage covered by warranties. The community manager can help the owner-controlled board find independent legal counsel to handle the legal issues that may arise for the association.

The community 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, roofing systems, and window assemblies. It is helpful to bring the original reserve study, which should list all components with a service life of fewer than 30 years that the association must maintain and replace.

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

The Incoming Manager

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

The incoming manager must work 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, the safety of the association's members, and the state of the association's financial affairs. The incoming manager should also develop relationships with board members, employees, independent contractors, and other staff.

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, 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 in the maintenance manual that are the association's responsibility.

Chapter 3

GOVERNANCE OF COMMON INTEREST DEVELOPMENTS

Since 1985, common interest developments in California — condominium projects and planned developments — are governed by The Davis-Stirling Common Interest Development Act, codified in California Civil Code §§ 4000, *et seq*.

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

California corporation law imposes upon each director a fiduciary duty to act in the best interest of the association. Each director's job performance is measured by what courts call the "business judgment rule." Essentially, directors must act in the best interest of the association and perform their 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, directors must subordinate their personal interests to those of the association when 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 in the community, enhance the value of the common assets, and ensure and improve the long-term viability of the association's financial assets and infrastructure. The board delegates the day-to-day operational duties to the community manager and oversees their performance. Owing to changes in homeowner association law, more boards are also delegating certain responsibilities to executive committees of the board.

The developer prepares and records the documents which serve as the "constitution" of the association—the governing documents, which 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 rules by which members are expected to live and interact with one another within the community. Generally, the articles and bylaws address "corporate" issues, while the CC&Rs dictate the use of common areas and property owned by the members (technically called "separate interest" property).

The business judgment rule provides the board of directors with protection when interpreting the governing documents and deciding on association operations. When deciding on association and community-wide issues, directors who act in good faith and in a way 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 avoid personal liability.

Chapter 4

PREPARATION OF THE DOCUMENTS

WHAT DOCUMENTS SHOULD THE BOARD OF DIRECTORS REQUEST FROM THE DEVELOPER?

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 are formally requested in writing by the Association's lawyer, its community manager, or one of the Association's directors allowed to make the request. The reason to make the request in writing is to 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, the board should use a checklist to confirm and record what was received. A book listing can be made, or an electronic record stored to show that the document has been secured. If records are missing, follow-up requests should be made to the developer to find or re-create the record or to explain missing records or materials. If 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 describe the documents in these five categories and why transferring and reviewing them 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 in the next five chapters. The checklist can be found at the end of the booklet.

Chapter 5

LEGAL DOCUMENTS

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 questions regarding 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—CCRs and Corporate Articles of Incorporation and 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
- 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 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 placing utility poles, utility trenches, water lines, or sewer lines. There are several types of easements (i.e., public vs. private, appurtenant vs. in gross), the details of which are not important for this guide. Most easements are recorded against the property they affect. Some easements are also within the CC&Rs themselves.

One part 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. So, the association should know any easements detailed in the governing documents and understand the rights and responsibilities charged upon them to enforce the easement.

The new owner board should also ask about *undisclosed* development encroachments or easements. The developer may need a special easement to complete work underground or across government property. During development, the invoice for any expense associated with the easement goes to the developer's office. These development easements or encroachments may be undisclosed on the title and only kept with the Public Works office. When the developer transfers the property, the bill goes to the developer, but it doesn't pay. Later, Public Works traces the charge to the property and sends the bill to the association years after the fact with charges that date to the beginning. Like a property tax, the government can foreclose the lien *against the property*. The owner board's demand for documents should include these so they can be reviewed at transition.

Agreements

The developer and the board may enter into special agreements about the common interest development. If any special agreements were made, the member-controlled board should know 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 development, and a board should have counsel review these. Demand and get clarity on any *implied equitable servitudes*. These informal "arrangements" do not appear on an owner's title or in the governing documents of the association but could bind the developer. Here are three examples we found:

(a) A golf course is next to the association. The project is sold with "golf course views" and a discount at the golf club if you are a member of the association. However, neither the association nor any individual member has a written agreement with, or a legal

interest in, the golf course property. Later, the developer who owns the golf course wants to sell or develop the land. There is case law that there might be an implied equitable servitude that would not let the developer change the character or use of that property.

(b) Association towers are built by a developer with a hotel (either in the association building or separately). When buying a unit and becoming a member of the association, the member is told they may receive reduced fees at the hotel spa, bar, restaurant, or on rooms. There is no written "contract," however, between the association, the association members, and the hotel. If the hotel cancels that arrangement, what rights do the members have?

(c) A "tot lot" playground is developed among several individual projects, each with its association. The developer owns the lot, and it builds the projects around the tot lot. The developer records the title in the last association when all the developments are complete. The tot lot may be an implied equitable servitude to the other associations whose members bought while the developer had control before the title was granted to the last of the developments.

There is a new DRE procedure that allows for special agreements between the association and the developer that lets the developer lease to the association, for purchase, the community center or other expected area improvements by creating a "Purchase Price Sinking Fund" payable from the association to the developer even after all the units are sold. Boards need to know if such an arrangement exists.

Recorded Maps, Condominium Plans, and Deeds

California Civil Code section 4285 defines a "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 accurately identify the location and description of all the units and designate all other areas (i.e., the common areas, restricted areas, parking, etc.) within the community. 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 a condominium map or plan and any deed to common area property in planned developments to make sure the board understands which areas are designated common areas and which are designated as separate interests and the rules that govern their use.

DRE Public Reports and Budgets

The California Department of Real Estate ("DRE") sets forth policies and procedures for developers to ensure the developer follows the real estate and subdivided land laws when offering homes or condominiums for sale to the public. To make sure the developers follow real estate law, developers must apply for and obtain a Public Report from the DRE. The DRE Final Public Report is often referred to as the "White Paper." Public Reports have 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. Often, there will be several versions of the Public Reports, especially for phased and larger developments or those subject to a long 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. The board should obtain that budget. It will normally be adequate for the association for the first year of operation. However, after the first year, the new board would be wise to review the budget to determine if it is an accurate representation of the project's actual operating costs. If the budget is deficient, the board has the power to amend or adjust the operating costs, and if the review shows that the developer did not properly account for all reasonably expected costs and expenses, the Association may have a claim against the developer for underfunding the Association's operations.

A new owner board should inquire of counsel whether the provisions of California Civil Code § 5551, which require safety inspections of certain balconies, stairways, and other exterior components intended for human occupancy, are applicable to the new project and, if so, the deadline for those inspections, and whether the inspection costs have been included in the developer's budget.

Owner board members should also be aware of DRE Regulation 2792.16(c), which allows for provisions in the Governing Documents for assessments to be *reduced* if a common interest component is not yet completed. Typically, the developer would have to pay the total assessment for every unit not sold after the first close of escrow.

Finally, more associations are transferred with an allocation of utility expenses directly to individual owners. For example, if water charges were included in the assessment, now the costs would be transferred individually to the purchaser. The association should do calculations and not rely on what the developer had set up.

Declarations of Annexation

A Declaration of Annexation is another document that the developer must 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. Once annexed, the homes within that phase may be sold, leased, transferred, and occupied pursuant to the terms of the 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 is used and how the community association is run. They are recorded with the County Recorder's office. They have a legal description of the common interest development, identify the type of development, and set forth the restrictions on the use or enjoyment of the property. The CC&Rs will include, for example, 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 and any amendments 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 help 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 any owner can enforce them against the Association if it is not properly carrying out operations). The member-controlled board should avoid situations where it may have to enforce rules and regulations with which the community does not agree. So, directors should always be alert to potential amendments to the CC&Rs to reflect community preferences, so they can comfortably enforce the rules.

The Articles of Incorporation create the corporate association entity and are filed with the California 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 have the rules for the operation of the Association and define the powers and the way 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.

Association Rules

In addition to the rules outlined in the governing documents, the Association may have separate 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 rules typically go above and beyond the "boilerplate" rules 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. The new board should 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 approving 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 enacted by the Legislature in 1985 and has statutory provisions regarding the creation and functions of common interest developments in California. It is covered in California Civil Code § 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 many others.

Architectural Approval Request Forms and Forms Granting/Denying Requests

The member-controlled board should know 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 materials used, and the height requirements for the fence.

To ensure the fence is constructed according to the architect's specifications, the architect may have an Architectural Approval Request Form which the Association must submit to the architect before 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 before changing 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 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, the newly elected board should maintain that record in the owner's file until the owner no longer lives at the property so future owners will be on notice of the violation.

Legal Opinions

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

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 too, 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 goals for the new Board of Directors.

Minutes of board meetings and decision-making committees

Most responsible developers maintain minutes of board meetings and decision-making committees under their supervision. The extent of the minutes varies and depends on the issue, but there should be minutes that mirror the meetings held and the decisions 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

DAY-TO-DAY OPERATIONAL DOCUMENTS

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 documents listed below are self-explanatory and are therefore not discussed in any detail. However, if the member-controlled board has questions regarding the importance or relevance 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 and Fobs
- 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 homeowner's association, whether there are 20 owners in the development, 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 and that this list is kept current.

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

If there is assigned parking at the development, the new board will need to make sure 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 earlier 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 about 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 important to obtain from the developer are the records associated with past voting, amendments, or ballots. Voting and ballot information are essential because the Association must follow strict rules and regulations about voting. It should have a complete record of all past voting and elections 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 and 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 affect its operations. If the developer-controlled board is participating in legal claims involving the Association, the newly elected board must learn the details 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 must 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.

After the first organizational meeting, the board of directors may have special meetings or executive sessions 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 to the homeowner board during the transition period.

Pending Special Assessment Information

An owner in a common interest development pays monthly assessments or fees to the homeowner's association to pay for insurance, exterior, and interior maintenance, water, sewer, and garbage costs. Fees are set by the developer-controlled board and can vary depending on many factors (such as whether the Association has a pool, fitness center, or doorman). Some developers have an interest in keeping the monthly assessments artificially low to entice buyers. Often, Association assessments set by the developer are inadequate to cover the operating costs of the Association, so the assessments must be increased. Assessments are typically increased yearly, 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 these increases, membership approval may be needed for the new assessment levels.

Chapter 7

FINANCIAL DOCUMENTS

Under Civil Code § 5300, the Association must maintain various "financial documents" relating to the project, and these are noted below. To properly maintain these records, the board should engage professionals to help, including certified public accountants, certified investment and tax advisors, licensed construction experts, and banking professionals.

Documents that 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 about any reserve deficiency expressed on a per-home basis;
- Notices of Assessment Increase/Special Assessment;

- Statements about assessment collection and enforcement procedures;
- Schedule of monetary penalties (fines);
- Reports about the Association's outstanding loans;
- Summaries of the Association's insurance program;
- All past 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 roadmap 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 the association's payments and expenses. The Association must keep accurate books showing all transactions within various accounts over a specified period. 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 spending and its actual spending. These statements will help the Association and its financial consultants in forecasting future spending overruns or budget surpluses.

Chapter 8

MAINTENANCE AND BUILDING RECORDS

The board of directors is responsible for making sure 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 community manager all 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 start the manufacturers' suggested maintenance protocols will significantly diminish the life expectancies of the building parts 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 provides the Association with a maintenance protocol for a building component that is a common area asset, the board and the community manager should make a specific request for one or devise a maintenance protocol. This may require the transition team to retain experts to

help in creating the protocol. The transition team should also augment whatever maintenance protocols it receives from the developer.

The Association should request these documents from the developer that will help the newly elected board and its community manager in achieving a transition that preserves and enhances the Association's common areas.

- Inventory of the 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 the transition
- Locations of key components (water shut-off, irrigation valves, gas valves, emergency systems)

Chapter 9

MISCELLANEOUS DOCUMENTS

The following is a list of miscellaneous documents the newly elected board should request from the developer before 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 kept by the developer-controlled board and provided to the member-controlled board during the transition.

Lawsuit Settlements and Records

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

CID Registry

The CID Registry of California™ has databases on about 39,000 Community Associations in California's 58 counties (48 counties in Northern California and ten 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 these 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 has the most current information about their Association.

Bonds

A bond is a written guarantee or pledge purchased from a bonding company (usually an insurance company) to guarantee the performance of a duty 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 on 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

(until 80% of the homes in the development are sold), the Association may demand that the bond company do so. The homeowner directors on the board should demand copies of the bond(s) and planned construction statement. The bonds have a *very short* statute of limitations, and unless claims are made timely, it will be difficult or impossible to obtain recovery from the bond companies.

Loan Documents

California law lets homeowner associations 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 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.

Senior Age Housing Verifications and Federal Compliance Certificates

Generally, it is against the law to discriminate in housing based on age. Senior Housing developments enjoy an exception to this general rule. If the common interest development is a Senior Housing development – a housing facility specifically designated for people over 55 – it may receive an exemption from normal discrimination laws. To preserve the exemption, however, the Association must follow the rules mandated by the Federal Fair Housing Act and related laws. For example, the community must follow the 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 people over a certain age.

The newly elected board should make sure it follows 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 does not comply, 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, so it should be avoided at all costs.

Chapter 10

THE IMPORTANCE OF THE AUDIT

We have stressed throughout this book the need for the member-controlled board to obtain and review the documents and records received from the developer-controlled board during the transition process. Some of these documents will be sophisticated and outside the realm of experience of those not specially trained. Thus, the homeowner board should also consult an expert to help in auditing 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.

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 duty 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. The new member-controlled board very should 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 help 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 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 make sure the newly elected board can operate and manage the Association smoothly with the rules 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 in the governing documents will work for the Association. As fiduciaries, they are to enforce those rules and must comprehend and support them.

Construction and Common Area Audit

The newly elected board should also retain the services of a professionally licensed architect or engineer to inspect the property. The inspection should consist of a thorough review of all major systems, including the roofs, siding, foundations, electrical systems,

plumbing, 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.

In addition to the audit above, Civil Code § 5551 was added to the Davis-Stirling Act in 2020 because of the fatal collapse of a building balcony in Berkeley, California, in 2015, which killed six students. It requires safety inspections of certain balconies and other exterior load-bearing components intended for human occupancy. The specific requirements of Civil Code § 5551 are beyond the scope of this book, but generally, an investigation of these components is required to be conducted by a licensed architect or structural engineer within six years from the issuance of a Certificate of Occupancy for any project where an application for a building permit was submitted after January 1, 2020.

Since a Certificate of Occupancy will normally be obtained by a developer before home sales can begin, the six-year deadline for the inspections may occur shortly after the owner-controlled board is elected. Reserve study preparers must review the results and add funding as necessary to meet future repair obligations to maintain the safety of these exterior components. Newly elected boards are encouraged to consult with their legal counsel for help in determining if the statute applies.

Another very important (and often overlooked) part of the construction audit is for the newly elected board's legal counsel to review the documents and confirm that the Association does own all

the common areas. This may sound like a silly proposition; however, in the business of construction and transfer of real estate, it is possible for a document to be misplaced, overlooked, misinterpreted, etc. Therefore, it is the board's responsibility to make sure the recorded documents are correct and that the Association does own all the common areas of the project.

Chapter 11

RESERVES AND RESERVE STUDIES

Civil Code §§ 5500 – 5560 set forth the duties of a community association's board of directors regarding reserves and reserve studies.

When homeowners pay assessments, they are funding both current operational needs and reserves. Reserves are funds set aside to finance the 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 must 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 annually review 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 determine the current state of the Association's financial position. Second, a reserve study helps determine whether the Association has reserved enough money to pay for long-term maintenance of the common assets and for the replacement of worn-out equipment and building components as part of the Association's common assets.

All building components, especially mechanical components like elevators, the HVAC system, and garage gates, require periodic maintenance, occasional repairs, and replacement at the end of their useful lives. An Association generally has a legal duty to make sure the Association has enough money 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 certain to materialize. This approach, which is commonly called 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 enough money to deal with the contingency. This approach is commonly called the "cash flow" method. While it may work for a community association whose members are financially capable of writing checks to cover big expenses ($50,000 per member to replace the roof or balconies, 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 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 of performing the work on that component. Second, the board should hire financial experts to determine the Association's current financial position and then determine a possible funding program based on the construction experts' estimated costs for maintaining, repairing, or replacing the major components.

During the transition phase, the owner-controlled board should seriously consider commissioning a reserve study to make sure the reserve account which the developer created has enough money. 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 attracts a different mix of buyers than the original market analysis that supported 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 independently analyze 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

INSURANCE

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 examples below. New member directors need not understand all the nuances of coverage but should be generally familiar with the policies required and what they cover (and don't cover). Here are examples:

Property and Casualty Insurance Policy:

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

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 bodily injuries during this accident, the CGL policy will defend the Association and pay the guest's damages. Typically, a CGL policy has 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 must obtain a policy limit of at least two million dollars ($2,000,000) for its directors to obtain qualified immunity from claims. If the Association has over 100 owner-members, the minimum required policy limit for this qualified immunity is three million dollars ($3,000,000).

Directors & Officers ("D&O") and Company Policies:

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 buy the "employment practices" coverage which is available as optional 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 must obtain a policy limit of at least five hundred thousand dollars ($500,000) for its directors to obtain qualified

immunity from claims. If the Association has over 100 owner-members, the minimum required policy limit is one million dollars ($1,000,000).

Fidelity Bond:

A fidelity bond protects the Association's financial security against losses caused by embezzlement. Even with tight financial controls, the Association's funds could still be stolen by people 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 unnecessary to preserve the volunteer director's immunity from personal liability, it is prudent for the new homeowner-controlled board to consider the Association's protection.

Earthquake Insurance:

This 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&Rs 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&Rs to require the board to buy earthquake insurance to protect the Association's common assets if it was so desired.

In considering these insurance policies, the board should consult a knowledgeable insurance broker to make sure the Association obtains enough insurance protection for all its financial risks. The Association's insurance program must be 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

TIME LIMITS FOR BRINGING CONSTRUCTION DEFECT CLAIMS

During or after the transition process, the Association's board may learn 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 many 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 laws to help resolve them. They are mostly 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 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 called the "Right to Repair Act"), but they haven't. The law –especially the time frames required for notices and action – are complicated and, at this stage of the process, not useful for homeowner associations. Without the guidance of professionals – attorneys, construction experts, and others –the laws are tilted against obtaining a resolution favorable for the association except for claims involving insignificant sums.

Under Title 7, an Association must pursue its construction defect claims within certain time periods ("statutes of limitation"), or else the Association's legal rights to pursue those claims will expire and

forever be barred, meaning that the Association must pay to correct whatever defects exist. Each building component has its own statute of limitations or statute of repose, and they range from 1 to 10 years. The "trigger" for when the statutes of limitation or repose 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 repose expires should *never* be determined by anyone other than competent legal counsel.

There are new, shorter statutes of repose that apply to the work of constructing a community association. Unlike a statute of *limitation* that starts the clock running to timely bring a claim when damage has occurred, statutes of *repose* start when the community construction is substantially complete. The periods for bringing a claim or forever being barred are as short as one year, so having a construction audit can never be said to be premature, even when damage has not yet occurred.

For Title 7, each period is triggered on the earliest of several dates relating to completing the building or the date the builder relinquishes control over the association's ability to decide whether to initiate a claim. Since developers frequently release control of whether to initiate a claim in the governing documents, it is likely that the developer *never* had control, and the statute of repose will be triggered at the close of the *very first escrow*. This means that the statutes of repose below could be triggered well before the homeowners gain control of the board. The association, through its owner-controlled board or even through an individual owner/director on the developer-controlled board, must act prudently to adequately protect the interests of the Association during the

transition. One thing that is clear is that the limitation periods are short; here are 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 duty if it does not promptly notify the developer in writing of significant Title 7 claims. More than that, putting a developer on notice starts a process that, if successfully concluded, will garner the Association enough money to fix the defects without undue burden on the members. This process may include the commencement of litigation, negotiation, and in rare cases pursuing arbitration or trial.

Chapter 14

MIXED-USE COMMON INTEREST DEVELOPMENTS

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 often have a single-owner association that governs both the residential and commercial communities. Larger mixed-unit 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 are more complicated than in a residential project – should be understood, especially in relation to maintenance, insurance, and cost-sharing.

All 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

KEYS TO A SUCCESSFUL TRANSITION: THE THREE "C'S"

Transition can be a complicated, long, and sometimes contentious process, but many problems can be avoided if the developer-controlled board and the homeowner members follow the three "C's" – Communication, Careful Review, and Competent Counsel.

COMMUNICATION

Effective communication is one of the most important keys to a successful transition. But 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 when 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 also lets the owners develop trust and respect for the developer, which helps with the 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 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 to resolve a problem with their unit or the common areas all by themselves and often will wait until an annual meeting or a situation where there are several homeowners gathered before speaking up. To ease the homeowner's fears, the advisory committee can 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 in the developer.

Another way to help with 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 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 the 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 way that serves the association's best interests.

A community association will succeed if the developer and members communicate openly and honestly. Effective communication by the developer-controlled board at the outset fosters a friendly and smooth transition period and instills trust in the developer by the members.

CAREFUL REVIEW

Another important part of the transition process is the 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 request all relevant documents from the developer and to carefully review those documents and make changes if necessary. This task should not be completely delegated to the manager. Once educated, the board can responsibly deal with the developer and transition issues that arise.

COMPETENT COUNSEL

The complexity of the developer-drafted governing documents and the Davis-Stirling Common Interest Development Act (and its constant evolution) mandates 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 helps in drafting the governing documents and sales documents and in the development and construction of the project. Many states have rules and regulations about the transition process. So, the governing documents created by the developer should be drafted so they follow state and local laws and so they develop a reasonable turnover schedule.

Although the developer's attorney is involved in many parts of the development and construction of the project, the community association should be represented by its own counsel to avoid a conflict of interest. Many states forbid an attorney from representing both the developer and the association.

To avoid a conflict, as soon as possible after assuming control of the association, the member-controlled board should retain its own independent legal counsel. The board should actively 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 make sure the documents aren't too rigid and difficult to amend. 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 you and the Association a smooth and proper transition that will last a "community" lifetime!

GLOSSARY OF TERMS

Non-Legal Terms

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.

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.

Mixed-Use Development

A mixed-use development comprises 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 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.

(b) "**Common area**" means the entire common interest development except for 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 survey monuments 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 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 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 expenses. 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 its 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			

II. MISCELANEOUS DOCUMENTS

Document Type	Date Requested	Date Received	Document Location
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

Document Type	Date Requested	Date Received	Document Location
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			

Download our convenient Transition Checklist as PDF file by scanning this QR code.

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 values; 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			

Download our convenient Transition Checklist as PDF file by scanning this QR code.

BERDING | WEIL

HOMEOWNER ASSOCIATION CONCIERGE PROGRAM

The directors of your community association will encounter many issues while tracking the health of your building as it ages. The first 10 years are critical to getting the project off to a strong start by carefully planning and funding inspections and maintenance. We have created a program to help the community head off problems during the early life of the building.

We understand the challenges that directors and community managers face with day-to-day maintenance concerns and the long-term repair problems that develop. What we call a concierge approach, to support and guide the board, is a great way to protect and sustain your building before serious problems arise.

OUR APPROACH:

1. **Provide** your community with an experienced team to work with the board and management through the early life of the project using a unique set of materials.
2. **Meet** with the board of directors to discuss any initial concerns and conduct transition training from developer to homeowner control.
3. **Review** the association's governing documents and maintenance records to identify the association's repair responsibilities; the dispute resolution requirements; possible triggers for statutes of limitation; indications of construction issues; and provide analysis.
4. **Organize** inspections for those components that may be subject to statutes of limitation or repose.
5. **Retain** an appropriate expert — architect or engineer — to conduct visual inspections of at-risk components and determine what other inspections may be required by Civil Code §5551— the balcony safety statute—and advise the directors of any additional inspections necessary.
6. **Meet** with the board to discuss our findings and the findings of each inspection.

BERDING | WEIL will undertake these investigations, retention of experts, meetings and review **without cost**[1] 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.

[1] Our fees are complimentary, and we will make every effort to obtain experts who will do preliminary visual investigations at no cost to the association. However, depending on the design of your buildings, the investigation required by Civil Code §5551 can be extensive, require intrusive, as opposed to simply visual, investigations, necessitate the retention of contractors, and carry significant cost if done independently and properly. In certain circumstances some or all those investigations can be accomplished in conjunction with investigations supporting an association claim for defective construction. If so, we will take all necessary steps to include that expense as part of the association's claim.

800.838.2090
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ATTORNEYS AT LAW

Notes

Notes

REQUEST

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BERDING | WEIL's Guide to Community Association Transition is also available as PDF download, and additional hardcopies can be requested from:

www.berdingweil.com/transitionguide/

or simply scan the QR code below:

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