best practices

REPORT #7

Transition
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- documented criteria for function-specific best practices;
- case studies of community associations that have demonstrated success; and
- the development of a showcase on community excellence.

The benefits of benchmarking and developing best practices include: improving quality; setting high performance targets; helping to overcome the disbelief that stretched goals are possible; strengthening cost positions; developing innovative approaches to operating and managing practices; accelerating culture change by making an organization look outward rather than focusing inward; and bringing accountability to the organization because it is an ongoing process for measuring performance and ensuring improvement relative to the leaders in the field.

The Foundation’s entire catalog Best Practices Reports is available at www.cairf.org as a free download and for sale in CAI’s bookstore.
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SECTION ONE

Introduction

Since the early 1970s, community associations—condominium associations, cooperatives, and homeowner associations—in the United States have experienced exponential growth. It is anticipated that this growth will continue for the foreseeable future for generally the same reasons as in the past—that is a combination of regulatory pressures as well as the need for a housing alternative that offers not only a wide range of pricing options but also an array of services and activities not generally available with a single-family home purchase. To put this growth in perspective, while it is estimated that 13 percent of the residential housing in the United States is in some form of community association, 80 percent of all homes currently being built are in associations. This 13 percent represents 249,000 associations and nearly 20 million individual units nationwide. Assuming that each unit houses only two residents, this would mean nearly 40 million residents. Realistically, this number is closer to 50 million as the average household contains more than two residents.

When making a major purchase such as a home in a community association, one of the key concerns of all involved has to do with the expectations associated with what will be received. Whether the expectations are presented as part of the governing documents, as part of the promotional literature used to sell the units, or by the builder’s representative on the original board of directors, if the actual purchase does not match the expectations created, disappointment and disillusionment may occur. This can translate into all parties spending a great deal of money and energy to resolve both perceived and real problems. For this reason, thought must be given to the design and development of any community association so that expectations are both realistic and realized.

As with any industry experiencing such rapid growth, associations must resolve their growing pains in order to continue their expansion. In the October 2002 edition of Builder Magazine, published by the National Association of Home Builders (NAHB), Gary Garczynski, president of NAHB at the time, writes, “Builders nation-wide are finding that costs for general liability insurance are soaring,” and that “the primary cause of the problem is simple: construction defect litigation…” He uses California as an example of the results of this litigation when he states that “since 1994, litigation has discouraged the construction of townhouses, apartments and condominiums. Multi-family for-sale starts dropped from 18,681 in 1994 to just 2,945 in 1999, an 85 percent decline.”

Similarly, in the January/February 2003 issue of Guidelines For Improving Practice, which is published by Schinnerer, the main provider of liability insurance for design professionals, the lead article is titled “Multi-Family Housing Claims Wreak Havoc.” This article indicates that for design professionals, “Multi-family housing is the biggest loser (when it comes to evaluating risk). This project type represents the highest risk of claims compared to billings, with an astounding claims to billings ratio of four to one.”

In the Builder Magazine article, Garczynski recognizes that some of the defect complaints are legitimate, and he indicates that builders are beginning to take a number of
proactive steps, “including improving quality control, providing better customer service, and providing homeowners with manuals that give tips on dispute resolution.” He also discusses how NAHB is working on model rules for homeowners and homeowner associations that incorporate a “notice of right to cure” process, in which builders are notified 90 days before the filing of a lawsuit.

While this issue is plaguing the designers and builders of community associations, it is also affecting the homeowners moving into these communities as well as the professionals who represent them by creating an adversarial situation. The relationship between the parties involved is formulated well before the first owner moves into one of these communities, during the design phase for the physical improvements and the governing documents. It continues during the construction phase and into the sales period, and then continues as the owners begin to take control of the association and the reality of what they have purchased begins to take shape.

In recognizing the negative impact that these problems are having throughout the industry, Community Associations Institute (CAI), which represents both community associations and their associated service providers across the country, and the National Association of Home Builders, which represents builders and their associated service providers, have joined together to address these problems in the best interests of all involved. To do this, CAI’s Research Foundation, CAI, and NAHB have prepared this Best Practices report on the transition process from the initial inception of the project through turnover to the owners.

The purpose of this report is to provide builders and associations with guidelines they can use to develop and turn over a community association project in such a way that transition becomes much easier and less confrontational. The ultimate goal of transition is for the unit owners to take over and move forward with a good reputation, with no litigation, and word-of-mouth sales.

| It is important to note the existence of feasibility issues based on the size considerations of the specific community under transition. Please consider the recommendations within this report as just that. For more information on transition issues, see Developer Transition, 4th Edition. |
SECTION TWO

What Is Transition?

Transition is a term that has evolved in recent years to describe the general process by which the control and responsibilities of the governing board of a community association are transferred from the developer to the persons who bought homes in the community association. Although it includes the assumption of the obligation to maintain the physical assets for which the association is responsible and is often viewed only in that narrow context, the transition process is much broader in scope. It includes the transfer of governance, the acceptance of the common property, and the accounting for funds. Transition is not a single event, such as the election of an owner-controlled governing board or the execution of a settlement agreement regarding construction defects in the common property. It is a multi-stage process of many events taking place over a period of time.

From a philosophical standpoint, transition begins many times as each new owner moves into a community association. At that point, he subjects himself by virtue of his ownership of his home to governance by the association that the developer has established for the operation and administration of the community and to the provisions of the governing documents of each such association—including the bylaws, restrictive covenants, and rules and regulations. Except for uncompleted or warranty work related to his unit, the owner must now look to the association rather than to the developer for guidance and assistance in dealing with common property and other community problems. However, the line between developer and association responsibilities is not always a clear one, especially when it comes to physical defects. More often than not, neither the developer nor the owner has an accurate or similar perception of the respective roles of the developer and the association.
SECTION THREE
Case Studies of Transition from Developer Control

The first opportunity that owners will have to become involved in their community association is during the process in which the association transitions from developer control. The following four case studies are examples of the process by which one developer and three community associations successfully transitioned to homeowner control.

case study #1

A Model for Developers
IDI Group Companies is a well-known developer in the Washington, D.C., metro area that has developed more than 12,000 primarily luxury, high-rise condominium units. IDI Group Companies continually demonstrate best practices for developers, such as the right way to bring on a new community association, the right way to negotiate warranty claims, and the right way to have people feel they are immediately a part of the community. Below is the basic model used by IDI Group Companies to transfer control from the developer to the association.

Shortly after 25 percent of new owners in a building settle, a resident orientation is held, and owners are encouraged to participate in the committee structure. The committees usually start out with terms of reference and other pertinent information found in a notebook given out to help them become familiar with the community association’s structure. Generally, IDI establishes five committees in the beginning—Activities, Budget & Finance, Building & Grounds, and Communications & Rules, as well as a Covenants Committee, which IDI oversees until the owners understand how the due process works.

When the settlements are nearing 35 to 45 percent of the building, the developer holds an election to place at least two owners on the board. Based on experience, those who are elected are the owners who have been active in the committees, most often chairs. This also prepares owners to accept responsibility for the building’s management sooner than required by law.

The developer establishes an Ad-Hoc Engineering Warranty Committee made up of owners who have some engineering or related background to assist in selecting an independent engineering firm to evaluate the building for warranty purposes. Owners are given sample specs as well as the names of firms that are qualified to do this work. Once the engineer provides a report, it is sent to the developer for comment. The developer then meets with the committee, reviews what he is prepared to do, and negotiates with the committee and usually the board. This has worked very well over the past 25 years. There has never been a lawsuit or argument about the developer not acting fairly.
The owners have been genuinely happy, and the only attorney’s fees involved have been for the attorney who reviews the engineering report and final settlement papers. Generally, a reserve study is performed at the same time as the engineering study, so the owners are satisfied that the developer provided enough funds to leave the association in good standing.

By the time it is legally required to place owners on the board (50 or 75 percent of settlements), many of the owners have already been trained and educated on matters of budget, building structure, and so forth. On the night of the election of the full owner board, the developer attends to welcome the new board and compliment them on their progress. The first committee that starts work is the Activities/Welcoming Committee. This group plans “Get to Know Your Neighbor” parties and tries to get residents involved in a social way that makes them feel a part of the community. Residents of the Washington, D.C., area may have noticed several recent articles in the real estate section of *The Washington Post* that identified what people liked and disliked about their community. The positive comments focused on how people immediately welcomed them and asked them to join the activities. The negative comments consisted of people saying how their neighbors watched them move in but never came over to offer a handshake or a hello. Proper welcoming of all owners is a best practice that will set the tone from the very beginning. Five IDI-developed properties have won a National Community Association of the Year Award: The Rotonda, Porto Vecchio, Montebello, Belvedere, and Park Fairfax. The lesson to be learned—if the structure is set up correctly in the beginning and properly maintained, it will last a lifetime.

case study #2

**Ford’s Colony at Williamsburg**

- **Size:** 2,700 single-family homes, 80 townhomes; zoned for 3,250 units
- **Location:** James City County, Virginia
- **Board Size:** Five

Realtec Incorporated is the developer of this golf-resort residential property. Ford’s Colony is a 1999 National Community Association of the Year Award winner and a founding member of CAI’s Community Association Hall of Fame.

The community’s governing documents required transition to an elected board of directors when 75 percent of the 3,250 residential units were sold. Sales started in 1985, and by 1990, over a thousand units had been sold. With a developer-appointed board, communication with the homeowners was a top priority. Realtec established an advisory board of elected homeowners in 1990 to communicate concerns and issues from the homeowners to the developer as well as the developer’s responses and plans to the homeowners. This group also would begin the training and education necessary for elected homeowners to serve as the governing body of the association. The advisory board organized into committees representing the primary functions of the association: maintenance, security, finance, and recreation. In 1991, the developer appointed the elected chairman of the advisory board to the association’s board. Every few years, the
The developer appointed an additional elected homeowner to the board, so that by 1999, the elected homeowners occupied four of the five board positions. The developer’s representative continued to serve as chairman throughout this transition process, and the developer continued to maintain a right of veto as provided in the governing documents.

In 1996, the association board appointed a Strategic Planning Committee (SPC) to focus on the issues and due diligence of transition. Consisting of two developer representatives and four homeowner representatives, the SPC forecasted future sales and agreed to set transition for the year 2000. The SPC coordinated owner surveys, focus groups, a legal review of governing documents, a reserve study and inspection of assets, and a complete cataloging of the location and contact for as-built plans and important documents. The committee also created and published a plan for transition and updated it twice for the homeowners. Each action item included a responsible name and due date.

Transition occurred in the year 2000 without incident and at full value to the developer. Bylaws had been amended to establish staggered terms for the elected board, which chartered new committees to replace the functions of the advisory board’s committees. The association supports each board member and committee chair as an individual member of CAI and also maintains its own membership as a large-scale community association.

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case study #3

**Tapatio II**

- **Size:** 73 condominiums
- **Location:** Henderson, Nevada
- **Board Size:** Three

In 2000, there was a smooth transition from the developer, with items of concern being addressed to the board’s satisfaction. Most board members are CAI members who attend CAI’s seminars for educational purposes. The board of directors meets bimonthly, with homeowners in attendance given the opportunity to speak.

The board is fair, taking all facts into consideration before making a decision. The board has high visibility, is easily accessible, and works hard to make sure the rules are followed while taking into consideration the particular situations of the residents. There is good communication among the board, the owners, and the manager. The manager follows the board’s directions, monitors violations, and attends all meetings. Annual homeowner meetings are held in compliance with Nevada’s Common Interest Community statute, as are voting procedures, and the community has never had a problem achieving quorum. Annual meetings run smoothly due to strong organization and a president who keeps to the agenda. Tapatio II has also revised its CC&Rs to comply with Nevada’s Common Interest Community statute, so they are very user friendly. Rules and regulations are flexible and considerate of individual situations, and are reviewed annually with membership input. Because of this, there are few violations.
Tapatio II has several social events throughout the year, including potlucks, poolside get-togethers, and a Christmas decoration contest. A newsletter is produced by the secretary of the association and is published bimonthly. Residents tend to get involved because Tapatio II is a small community and everyone knows their neighbors. Most of the residents feel connected. There is community spirit and a desire to continue to make the community a good place to live.

**case study #4**

**Green Valley Ranch Community Association**

- **Size:** Master association of 3,907 apartments, townhomes, and single-family homes. There are 32 sub-associations, of which 16 are gated communities.
- **Location:** Henderson, Nevada
- **Board Size:** Seven

Now under owner control, Green Valley Ranch Community Association has a board of directors that meets monthly, with approximately 20 to 30 members attending. Members are given an hour in which to speak before the board’s discussions. Elections for the annual homeowner meetings are by proxy and secret ballot. Annual meetings run smoothly because of thorough planning and good communication. Members of the board receive training, including updates on new laws and the community. A monthly delegate meeting is held to help facilitate communications between the board and homeowners. In addition, the board has adopted committee charters, with a board member meeting with each committee to provide help and direction. The Legal Committee meets on a monthly basis with the developer and its general counsel to discuss transition issues and to ensure communication between the developer and the association.

The board of directors realized that building a real community was a key priority in helping to weather the transition from the developer, which was underway in 2000. As a result, governance in this community is particularly efficient and valued by homeowners because of constant communication via the Web site, newsletter, special notices, and social events. The newsletter is mailed to all residents every other month and has gone from four to 12 pages. Well-informed as they are, residents volunteer readily for the board and committees because they are dedicated to improving property values and building a sense of community.

Social events for residents helped resolve issues related to the transition. These social events included a summer open house at which owners could have their questions answered by individuals or committees. Tables with information about the committees were set-up. The Henderson Police Department, association management company, and landscape contractor also had tables. T-shirts with the Green Valley Ranch logo were displayed and sold at-cost to residents. A fall hoedown was held in a park within the community and involved local merchants and residents who own businesses in the community. There have been other events as well, including special socials for children. All of the events have been extremely well attended.
President’s breakfasts are held quarterly bring together Henderson officials, board members, the developer’s representatives, and delegates and presidents of the sub-associations to resolve issues facing the community. The board created a Political Action/City Liaison Committee to work with Henderson on issues facing the community. This has been so successful that the city is involving the board in several other areas where community input is needed.
SECTION FOUR

The Development Process

Prior to the creation of a community association, the developer (who may or may not be the builder) begins the development process. Once a tract of land has been identified, the developer must garner control of it. Typically, a developer will enter into a contract to purchase the land, subject to certain conditions. Once the ground is under control of the developer, the developer’s due diligence begins.

Initially, the developer focuses its due diligence attention on broader feasibility issues. A market analysis is undertaken, which centers on zoning ordinances, comparable unit sales, income levels of potential customers, and the quality of the local school district. Concurrent with the market analysis, the developer also performs a fiscal analysis, which estimates a project yield, raw construction costs, the time frame for approvals, and the project’s potential profitability. The fiscal analysis will continue throughout the life of the project—its fluidity being affected by changing markets, items learned during due diligence, and conditions attached during the approval process.

While the market and fiscal analyses are progressing, the developer orders a title search and title commitment, confirming the chain of title and any recorded encumbrances and restrictions of record on the tract of land. A phase one environmental assessment is conducted, the results of which may trigger additional environmental studies of the ground. Existing approvals, if any, together with out-bound surveys, topological surveys, soil maps, soil borings, and the availability of utilities are also reviewed. The developer’s engineers and professionals study wetlands, flood planes, and any other potential environmental constraints as each may affect the project’s overall yield. As noted, such items must be incorporated into the ongoing fiscal analysis of the project.

Throughout due diligence, rough sketch plans are prepared. Frequently, a developer will share sketch plans with local officials to solicit their input before more costly hard engineering plans are prepared. Once the developer decides to proceed with the project, more detailed engineering plans are finalized. It is at this point that the developer begins to consider the rights, powers, and duties of a community association. For larger projects, clubhouses and other amenities need to be designed and located on the plans. These clubhouses and amenities very often will be owned and maintained by the community association. In addition, traffic (both vehicular and pedestrian) and parking considerations need to be taken into account. Detailed engineering plans, which must comply with myriad requirements of the reviewing governmental agency, are then submitted to the agency, together with any application fee and professional escrow fees. Often, the plans are considered at public meetings, with the developer satisfying certain notice requirements before the meeting.

While local approvals are pending, the developer and its engineer continue to pursue
the remaining regional, state, and federal permits and approvals, some of which may be affected by changes made to the plans at the local level. It is during the approval process that additional burdens may be placed on the association. Municipalities, concerned that certain developer promises may be lost once the project is built-out, may require the developer to commit the association to certain obligations such as site maintenance. Developers, anxious to get approvals, routinely agree to such conditions.

SECTION FIVE

The Challenges

Construction
Construction is the phase of development on which the board of directors generally focuses as they take control of the association. This is the time when the quality of the workmanship and the adherence to plans and specifications can minimize the potential for construction defects to become an issue. Historically, this has also been the point that conflicts with the intent of a builder to obtain the highest profit such that the oversight of the construction may be ignored or minimized, since this may only slow down construction and will cost additional funds. Over the past few years, the high cost of returning to correct deficiencies identified as part of an association’s engineering evaluations has caused many builders to rethink this period and, in some cases, has prompted them to engage third-party inspections during construction to assure general conformance to the plans and specifications as well as acceptable workmanship. Builders have also engaged third-party consultants to review the final plans and specifications prior to construction in order to identify areas of high risk confirm general conformance of the plans and specifications with the descriptions contained within the governing documents and promotional literature. This risk management type of analysis generally has been felt to be beneficial in reducing the need for call backs as well as the time of the transition process, which in some cases can extend for a number of years.

Governance
A primary component of the transition process is the assumption of responsibility for the governance of the association through control of the board, which is responsible for the operation and administration of the community association and the maintenance of the common property. Preferably, this should be a gradual process that allows the owner board members the opportunity to receive proper training and to gain experience. Also, a progressive transfer of control helps protect the developer from unfriendly and financially harmful actions by the owner members of the board while the developer still retains a substantial economic interest in the project. In some states, legislative or regulatory mandates require that turnover of control of the governing board from the developer to the owners occur over the course of development. Commonly, the statu-
transition
tory guidelines require the election of a minimum number of owner board members at various stages of sales based on the number of projected closings that have actually occurred, beginning at 25 percent and continuing to 75 percent. At this point, the owners usually elect the entire board with the exception of one developer representative who can remain until the completion of sales for the project.

Preparation of the Documents
There is no exact triggering mechanism in the development process for the preparation of community association documents. Typical documentation includes the articles of incorporation, the declaration of covenants, conditions, and restrictions, and the bylaws. As a general rule, each document should be prepared as early as possible, once the details of the project begin to crystallize. More recently, local governments have sought to review the documents as part of the approval process. While in theory such a review should result in a better-conceived association, in practice it yields few positive results due to the voluminous nature and complexity of the association documentation as well as the frequent inexperience of the reviewers to the subtleties of association practice. Accordingly, developers seek to delay submission of the documents to the local reviewer until late in the process. In that way, the local reviewer can confirm that any final conditions of approval are met but need not get bogged down in the nuances of the association documents at an early stage.

Once a set of plans, the draft declaration, and bylaws are prepared, the initial community association budget needs to be established. A professional management company should review plans and documents before they’re finalized, and can also prepare draft budgets. For larger projects, plans and documents should also be forwarded to a Reserve Specialist, who can create an initial capital reserve study. This projected reserve analysis will then become a component of the budget.

Throughout the construction and conveyance process, the developer typically controls the decisions of the association. Once again, it is critical that the developer manage the expectations of the homeowners through this process. Expectations can be managed through meet-and-greet sessions, welcome packages, periodic association meetings, association newsletters, and Web forums. It is vital that the developer and the management company differentiate between association issues and homeowner issues. Moreover, during the entire development process, developers need to remain cognizant of potential issues and to try to alleviate those issues in advance of transition. By addressing potential issues, developers can help create community and avoid confrontation when the association is controlled by homeowners. A developer can also create community by soliciting homeowner involvement early in the development process.

While the developer must maintain control of the decision-making process, goodwill is garnered by soliciting homeowner input on key decisions of the association. Often, it is helpful for the developer-controlled association to set up homeowner committees to advise the developer as to the wants and needs of the community. Such committees can provide a valuable source of information as well as an opportunity to cultivate potential homeowner board members.
Recently, a trend has developed that may prove to be the best way of managing both the developer’s and the homeowners’ expectations. Certain developers have created an acceptance procedure manual and maintenance manual not only for homeowners but also for the association and its management company, so that everyone understands the transition process. For example, while there is a common misconception that the association has the right to accept or reject common facilities, it is nonetheless a good idea for the developer to proactively solicit homeowner approval of amenities before the transition. It is also a best practice for developers to turn over as early as possible the amenities and open space areas to be owned by the association. Once again, to the extent that the association can manage itself as it will after the developer has left the community, those expectations will carry over during the transition process.

Governance of community associations begins with the preparation of the governing documents by legal counsel on behalf of a developer. The association is created by recording promises and restrictions in instruments typically called trust deeds, declarations, CC&Rs (declaration), or governing documents. Some form of organization is then created to govern the community. The association is managed and operated through its governing body, which is typically known as the board of directors. The developer appoints the board for some stated period of time when the association is first created. Then, over time, non-developer owners elect members of the board.

The developer undertakes the creation of an association in a litigious society where state statutes and case law establish the standards to which the developer and its representatives will be held. The governance structure and the manner in which the community association goes through transition and turnover offer developers an opportunity to manage some of these risks. The governance structure must be flexible enough for the developer yet specifically establish the rights and responsibilities of the association, the owners, and the residents. The governance structure must be thoughtful and specific to each association. As the process of transition begins and ends with the governance structure, this report provides suggestions that will serve all stakeholders regardless of any conflicts among their interests.

An attorney’s diligent representation of his or her developer-client does not preclude creating thoughtful, user-friendly documents specific to the community association. Below are guidelines that the developer and its legal counsel should follow in order to enhance the association’s governance during transition and after turnover.

1. Draft governing documents that focus on the developer’s right and ability to control the development of the project and sale of the units rather than its right and ability to control the board. Developers should focus on architecture, design, development, and sales, not on control of the board. If design review is included in the community’s regime, the declaration should provide that the developer controls both the adoption of design guidelines and design review and approval until the last lot is sold or the last improvement is installed. In every declaration, the developer should reserve the right to control all design and development of improvements within the community association until the project is completed.

2. Create governing documents that enable rather than impede the business and financial management of the association. No provision should be considered boiler-
plate; even the most standard provisions should be drafted to meet the needs of the particular community association and to aid in a successful transition. For example, when drafting bylaws, the number of board members, length of terms, term limits, and election procedures should be considered in light of transition and post-turnover association operations.

3. **Create a governance structure that encourages involvement by owners and other residents.** Governing documents should provide procedures for securing owner involvement. From the outset, owners should have a say in covenant and rules enforcement, collections policies, insurance-adjustment policies, and issues concerning management and maintenance. The many tasks best performed by owners eliminate unnecessary work for the developer, identify and develop leadership, and give owners a sense of community and involvement in the governing process.

4. **Create a transition team within the governing documents.** A transition team of owners assures other owners that the directors appointed by the developer have managed the affairs of the community properly. Permitting owners to elect their own representatives on the transition team is always prudent. Meetings with the transition team offer developers the opportunity to inform owner representatives as to the physical plant maintenance, schedule for turnover of responsibility, budget process, contractual obligations, and the association’s record-keeping policies. The possibility for leadership development is enormous in this process.

5. **Include alternative dispute resolution in the governing documents.** Consider identifying and submitting potential claims to this resolution process as the control of the board transitions to the non-developer owners.

6. **Establish reasonable schedules for turnover (or honor state laws, as the case may be).** Many states have laws that proscribe the transition process and mandate turnover from developer to owner control based on a series of events and meetings. The governing documents should provide for a transition process that honors state law and, in the absence of statutory mandates, honors guidelines established by governmental and quasi-governmental agencies involved in financing units within community associations. The governing documents should also establish reasonable schedules for turnover through a phased and increased presence of owners on the board. The governing documents should provide for a transition process that establishes:

   (i) when and how elections of owners to the board occur;
   (ii) who is entitled to vote and (in states where permitted) whether class voting is allowed;
   (iii) how and in what manner developer-appointed board members are removed or resign;
   (iv) the continued right of the developer to control the development of the community association until completion; and
   (v) what documents, financial audits or reports, and other information is to be delivered to the owner-elected board.
Guidelines for Governance

Thoughtful document drafting will create a governance structure within which transition is viewed as successful by all stakeholders—if all those stakeholders take responsibility for their roles in the process. Though there are differences from community to community and state to state, transition is most successful in associations where the following practices occur.

1. Educate owners as to what a community association is and isn't. As construction in a new community begins, the developer board should apply for membership in CAI on behalf of the association. The developer should both provide written information (consider creating a Web site for the community association) and hold regularly scheduled sessions to introduce new owners to the concept of common-interest community living. At closings or in any new member packets, developers should provide a list of how owners might get involved in the community. With the population diversity in the United States, there will be language, education, and cultural barriers to the concept of self-government and to the obligations placed on the residents of these communities.

2. Educate board members. Incorporate board training from the outset first by educating developer-appointed board members as to the duties owed to both the association and owners, and then by educating owner-elected board members as to their duties and responsibilities. Knowledgeable board members who understand the duty owed to the association and the owners are more likely to exercise reasonably prudent business judgment, hold and document meetings, and generally act in a manner that will reflect well on the developer and serve the association's best interests. Additionally, local and state governments have become involved in leadership training, and there are weekly and monthly television programs throughout the country. Many local libraries contain a series of video programs and publications on community association subjects. Consider adopting a Code of Conduct for all board members.

3. Recognize the duties owed to the association and owners, and establish policies that enable the board to carry out these duties. By statutes in many states, developer representatives serving on association boards owe a fiduciary duty to the owners. Additionally, courts have held that the developer owes a fiduciary duty to the association to properly manage the project from the beginning. Thus, developers may be held liable for breach of fiduciary duties concerning defects in both the physical construction of a project and the association's business operations. Developers should adopt policies that instruct their board representatives in the parameters of these duties and how to avoid breaching them.

4. All board members must act in a fiscally responsible manner. Whether or not proscribed by state law, developers should secure a reserve study by a qualified professional and thereafter establish a plan for funding the necessary reserves. Note that the manner in which reserves are funded may be dictated by state law. However, the developer is well-advised to design a plan based on the particulars of the community—there is no single plan that works for all communities. In states where required, incorporate
provisions for reserves in the governing documents. Similarly, both developer-appointed board members and owner-elected board members must adopt budgets based on reality. The developer must transition a community that is financially stable by establishing adequate assessments and aggressive collections policies.

5. **Engage professional management.** On behalf of the association, retain professional community association management. Be careful to ensure that the terms of the management engagement are standard and that fees paid are typical in the industry. As the community’s historian, the manager should ensure that all the appropriate records are kept, so that at turnover all information is passed along to the association.

6. **Hire independent legal counsel to represent the association.** On behalf of the association, secure and include in the association’s annual budget independent legal counsel to represent the association through transition. In most states it is a violation of the regulations under which an attorney practices law to represent both the association and the developer.

7. **Support the homeowner board through the completion of the community.** The developer and all participating builders have a responsibility to support the owner-elected board. A joint approach to the completion of the community will provide the developer with positive feedback and possible referrals as other new developments are created.

8. **Maintain a relationship among the association, the developer, and the owners after turnover.** Developers who foster strong resident member identity with the governance of the community find the long-term relationship proceeds smoothly. Plus, a successful transition is a terrific risk-management tool.

**Communications**

Effective communications is probably the most important element in the success of any community association. Especially during the developer control period, a successful communications system can forestall the development of cliques and factions, enable the association to provide services that owners want, and help owners develop a sense of trust in the developer, reducing or eliminating the acrimony that often follows the transition to owner control.

An effective communications program is composed of several components, each of which is an essential part of the program:

- **Homeowners** often feel that there is safety in numbers, and consequently only speak up in a crowd—such as at annual meetings when, for the first time, the developer and the manager find out about a leaking roof or an unreturned call from management five months ago. To avoid the angst caused by disgruntled owners, start communicating with them even before they move in by leaving information about the roles and responsibilities of the community association in the sales office. Invite them to a new owner-orientation meeting. Encourage them to participate in a welcome committee to personally greet their new neighbors and introduce them to the workings of their
association. Urge the creation and support of a newsletter committee to inform the owners about what’s happening in their community. Help them activate a social committee to begin the process of creating a unique community culture.

• **Realtor/on-site sales force** often provide the first impression of the community to a prospective owner, so they certainly need to get their facts right. The sales material should contain all information required by law as well as material that addresses the sense of community that forms the basis for the association. Holding quarterly open houses for real-estate agents at which the community manager discusses specific aspects of the association’s obligations to the owners can focus them on the need to apprise the owner of both his and the association’s responsibilities to each other. Real-estate agents must clearly explain the association’s existence and purpose to prospective buyers to prevent disillusionment and recalcitrance after the new owner realizes there are limitations on the color he can paint his home or the number of vehicles he can park on the private street. It’s better to learn beforehand of the restrictions established by the governing documents, even if it means that the prospect decides to purchase a home in a less-restrictive community.

• **Managers**, as the professional community association experts, are expected to educate and guide the developer and owners through the maze of governmental, regulatory, and internal laws and rules. It’s not a one-time effort, but rather a continuing program to remind existing owners of and introduce new owners to their community culture. First-time deed-restriction violation? A phone call goes a long way to establishing a warm, personal attitude toward the residents, much more so than a form letter that, no matter how much thought went into its language, will offend the recipient. The manager’s allegiance is to the association, and one of the indications of a truly talented manager is the ability to speak frankly to both parties about their obligations to each other.

• **Developers** have tremendous power that will directly affect the current and future operations of their communities. They can ensure that the documents are crafted to create a responsive, successful association. Here are a few tips:
  - Make sure the sales force clearly explains the maintenance and administrative responsibilities of the owner and the association.
  - Offer bonuses to both in-house and area real-estate agents for owners who understand their community. Don’t emphasize sales for the sake of sales; rather, focus on the community culture and ensure that each prospect reads and understands all the legal documents affecting his or her actions and behavior within the community.
  - At least monthly, send a communication to all the owners, if only a postcard letting them know how sales are going. If funds are low or someone is concerned about maintenance personnel or quality of work on common elements, respond immediately or refer the owner to the manager and request immediate follow-up.
  - Implement group closings, an owner-orientation program, or a welcome committee—all of which are designed to educate and involve owners.
If an owner reports a construction-related problem with his or her home, fix it immediately and cheerfully.

Create a homeowner advisory committee so that owners feel they have a real voice with the developer. This committee can relay comments and questions from owners to the board, and relay information from the developer back to the owners. While they may have no legal authority or power, the members of the Advisory Committee can significantly influence the mood of the community toward the developer after transition. Keeping them informed about both the good and the bad news establishes trust with the committee members and consequently with the other residents. The Advisory Committee can also be an incubator for future board members who understand the developer's efforts to turn over to them a community association already established as financially sound and responsive to its members.

- Hold quarterly town-hall meetings to flush out issues that can grow into marketing nightmares.
- Create a Web site to provide constantly updated information about sales and community activities.
- Encourage homeowner involvement in committees to groom potential homeowner board members as well as demonstrate a willingness for collaboration.

**Attorneys**, more than any other professionals, can single-handedly determine the success or failure of a community association. Rather than using decades-old language for the governing documents, take advantage of enlightened wording shared by many community association law practitioners. Provide the framework within which homeowners can construct an association that reflects their preferences. Don't create documents that are so rigid and intractable that they are too difficult to amend to reflect changing times and environments. Rather, craft documents that are customized for each community, so there are no references to an elevator in a garden-style condominium, greenbelts in a high-rise, or Dumpsters in a single-family subdivision.

The word “communication” has the same root as community for a reason. A community association is dependent on frequent, frank, open communication between everyone involved in its creation and existence in order to thrive and provide the quality of life expected by its members. The developer's goal should be to create a community of residents who are proud of their homes and their neighborhood and who view the developer as part of the team committed to the operational success of their association. Such attitudes foster amicable transitions and fewer lawsuits, reducing or eliminating the additional expense and time that transition litigation consumes.

**Maintenance of Common Property by the Association**
The assumption of responsibility by the association for the maintenance of the physical assets is another key element of transition. Normally, it does not take place until after owners have assumed control of the governing board, but this should not necessarily be
the case, especially in larger projects where the common property can deteriorate for a variety of reasons, including use, improper maintenance, and the effect of the natural elements. Therefore, the actual responsibility for maintenance of the physical property can and should be assumed by the association during the period of developer control to minimize future problems between the developer and owners as to who is responsible for repairs and replacements. It is important to recognize that in many common-interest developments, the association may be charged with the duty to maintain individual as well as common property and that a similar approach should be taken.

Financial Control
A financial accounting and transfer of financial records is another element of the transition process. Usually this occurs when the owners assume majority control of the board. However, consideration should be given to permitting an owner board member to serve as treasurer before the transfer of control in order to minimize the concerns of the owners and to encourage better discipline in keeping the association’s books. If there have been proper financial records kept during the period of developer control with annual audits and a clear segregation of association funds and employees from developer funds and employees, financial transition should not present a problem. Often, however, serious problems will arise when a developer does not establish and maintain separate books and accounting records from the time that the association is activated, which usually occurs at the time of the first unit closing. Utilization of association employees for developer work such as warranty service, preparation of units for closing, or model area maintenance can also be a trouble source.

Budgets
The preparation of an initial budget is a developer’s first look into the potential revenues and expenses of the association. In managing homeowners’ expectations, the developer and the management company preparing the budget should emphasize that the budget is based on proposed plans and developer estimates, and is always subject to change. Moreover, while developers typically have done an analysis of comparable projects and have a desired assessment figure, the budget preparer should not be constrained by that figure. If the budget is prepared early in the development process, then there should be ample time to reconsider and possibly eliminate certain amenities or obligations of the association in the event that the budget assessment amount is perceived to be too high by the developer.

Budgets, which are manipulated to meet desired assessment levels, threaten the successful transition of the association. More than any other disclosure of the developer, the disclosed assessment amount is frequently the most remembered. Homeowners may not remember when a transition election is scheduled to occur, but they will invariably remember the exact amount of the assessment obligation as quoted by the developer’s salesperson. Certainly the amount of assessment creates an expectation as to the qual-
ity of service to be provided by the association. When this expectation is not met due to changes in the plans or market conditions, the association transition is usually more adversarial.

Throughout the developer-control period, the developer should manage expectations. Budgets should be revisited and updated annually. With each new budget, an explanation as to why it may differ from the original should be provided, and input should be solicited from homeowners as to the level of services provided. Moreover, in communities where the developer initially subsidized the project, the amount of the subsidy should be accounted for and should also be explained to the homeowners with clear detail as to when that subsidy will end. Similarly, the developer should periodically update reserve studies during the developer-control period, in order to minimize any gap in reserves once transition occurs.

Litigation
Developers can be exposed to liability, either to a community association or to individual homes, under a variety of legal theories. The theories of liability range from breach of contract to fraud. In some instances, developers may face liability for violating state or federal statutes. Undoubtedly, the three areas of a developer’s activities that create the greatest potential for liability are construction, marketing, and sales.

Liability to Purchasers for Home or Unit Defects
A developer often acts as the builder of homes and/or condominium units in the planned community. If the developer assumes the role of builder, it is potentially liable for construction defects in the same manner as any other home builder would be.

1. Liability for Breach of Implied Warranties. With regard to the sale of new homes, the vast majority of states now recognize that the developer-builder gives each purchaser of a home two implied warranties. The first type of implied warranty is the warranty of habitability, which requires that a home be safe, sanitary, and otherwise fit for human habitation. The second type of implied warranty is the warranty of good workmanlike construction. This warranty requires that a home will be built in compliance with local or state building codes and with non-defective, high-quality materials. Pursuant to the warranty of good workmanlike construction, the developer-builder warrants that the home is free from latent defects of a substantial nature caused by a failure to build the home in a skillful manner.

2. Liability for Breach of Express Warranties. Today, most contracts pertaining to the construction of a new home include express warranties made by the developer-builder to the purchaser. An express warranty is a promise, made by the developer to the purchaser of a home, whereby the developer makes certain guarantees as to the quality or fitness of the home. If the express warranty is breached, the purchaser can hold the developer-builder liable for damages in an amount sufficient to permit the purchaser to remedy the construction defects. In some instances, the breach of an express warranty may entitle the purchaser to rescind the sale contract. Normally, express warranties are limited to the original home purchaser and cannot be relied on by subsequent purchasers. Some express warranties provide that, in the event of a dispute between the developer and the purchaser, the matter is sent to binding arbitration.
3. Liability Based on Common-Law Fraud. If a developer-builder expressly misrepresents the characteristics or quality of a home, it can be held liable for damages to the purchaser under a theory of fraudulent misrepresentation. Similarly, the developer-builder can be liable to a purchaser for failing to disclose defective conditions that a reasonable and prudent purchaser would wish to know about before buying a home.

4. Liability Based on Negligence. In some jurisdictions, purchasers and community associations may have a viable cause of action for negligence against the developer pertaining to the design or construction of a home or the common areas. To be successful against the developer under a negligence theory, the plaintiff would essentially have to demonstrate that the developer negligently created a defective or unsafe condition. Typically, a negligence cause of action would arise from the developer's failure to properly design a structure or from the developer's use of substandard construction materials.

5. Liability Based on Breach of an Implied Warranty to Develop in Good and Workmanlike Manner. Courts around the nation have held that developers impliedly warrant that the development, together with the development's amenities and common areas, are designed in a good and workmanlike manner. Pursuant to this warranty, the developer is under an affirmative obligation to exercise reasonable care and prudence with regard to all aspects pertaining to the planning and development of the new residential community. Today's developers are deemed to be more than mere sellers of raw land.

6. Developers Liability Under Deceptive Trade Practices Act. Most states have enacted what are generally known as deceptive trade practices acts. These acts prohibit unfair or deceptive practices in the conduct of any trade or commerce. If a developer misrepresents the purported quality or fitness of the home, or deliberately fails to build the home in accordance with the agreed-upon plans and specifications, the developer could face liability for deceptive and unfair trade practices. Most state deceptive trade practices acts permit the plaintiff to seek triple damages and attorney's fees.

Liability of a Developer for Misrepresentations Concerning the Amenities

In order to market a new development, developers will often focus their advertising efforts on the type of amenities planned for the community. Amenities can consist of recreational amenities, such as tennis courts, picnic areas, and swimming pools, or more fundamental things such as water and sewer availability, parking lots, and roads. Homebuyers have a right to rely on representations made to them as to the quantity and quality of the amenities. If a developer makes false promises as to type, quality, or quantity of amenities that will be available to residents of the development, this will entitle purchasers to sue the developer pursuant to either a breach-of-contract or fraud theory.

Developers Liability Under Federal Law

1. A Developers Potential Liability under CERCLA. A developer can face possible liability pursuant to the federal Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA), which was enacted in 1980 to address environmental and public-health problems created by the improper disposal of hazardous substances. The Environmental Protection Agency is authorized to sue those who created the environmental hazard as well as current owners and operators of the property upon which the improper disposal occurred. A developer who owns property contaminated as a result of
the improper disposal of hazardous substances thereon is liable for clean-up costs even though the developer did not participate in the improper disposal.

2. A Developer’s Potential Liability under RICO, the acronym for Racketeer Influences and Corrupt Organizations. RICO derives from the Organized Crime Control Act of 1970. Developers who deliberately make misrepresentations about a planned community in promotional literature sent via the United States mail, or who make misrepresentations pertaining to the planned community via telephone, radio, or television, could find themselves subject to a RICO suit by disgruntled purchasers. If a RICO claim is successful, the plaintiff can be entitled to triple damages, costs of the suit, and reasonable attorney’s fees.

3. A Developer’s Potential Liability Under the Interstate Land Sales Full Disclosure Act. The federal Land Sales Full Disclosure Act (ILSFDA) forbids the use of false, deceptive, or misleading advertising claims made with regard to unimproved subdivided lots offered for sale through means of interstate commerce. The ILSFDA permits buyers to recover damages for actions deemed in violation of the act.

**Liability of Community Associations**

Like a developer, a community association and its directors can face potential liability to homebuyers under a variety of legal theories. Many lawsuits against an association or its directors arise from an alleged breach of fiduciary duty. Community associations and their directors cannot act in an arbitrary and capricious manner toward individual homeowners, nor can they single out certain homeowners for disparate or discriminatory treatment. The fiduciary duty also requires that community associations and their directors operate the associations’ business and financial affairs with ordinary care, skill, and prudence.

A community association is normally charged with the duty and responsibility to keep common areas in a state of repair and maintenance. If this duty is breached, and someone is injured or killed as a result of the unsafe condition of the premises, the community association can be sued for damages in the same manner as any other premises owner or occupant. Similarly, if a failure to maintain the common elements results in damage to the property of a homeowner, the community association can be liable based on its neglect of the common elements.

**Lender Liability**

Lenders who loan money to developers can, in some instances, be liable for construction defects or misrepresentations pertaining to the development. If a lender’s role in the development is simply that of a lender, the courts have generally concluded that the lender is not liable for construction defects or misrepresentations pertaining to the development and its amenities. However, a lender can face liability for construction defects or misrepresentations if the developer has actively participated in the decisions pertaining to the planned development. Similarly, the lender can be liable for construction defects or misrepresentations in situations where the lender has (1) foreclosed on the development property, (2) taken title thereto, and (3) begun to hold itself out as the developer. The lender who becomes actively involved in a development could also face potential liability under the ILSFDA, RICO, and CERCLA.
Standing of a Community Association to Maintain an Action for Construction Defects Against the Developer

One cannot bring a lawsuit against another party unless he or she has standing to sue. Standing to sue means that the party bringing suit has a sufficient stake in an otherwise justifiable controversy to obtain a judicial resolution of the controversy. The requirement of standing is met if it can be said that the plaintiff has a legally protectible and tangible interest at stake in the litigation. Some courts have taken the position that a community association has no standing to sue a developer for construction defects unless the community association has an ownership interest in the defective property or is given the express authority to sue by virtue of state statute.

Generally, if the community association is suing the developer for defects in the common areas owned by the association or directly under its control, the association is deemed to have standing to sue. However, most courts have concluded that the community association has no standing to sue a developer for construction defects affecting only individual homeowners.

Standing of Individual Unit Owners to Maintain Action for Construction Defects Against the Developer

As a general rule with regard to community associations, there is no question but that an individual owner has standing to assert a claim against a developer due to the defective condition of his or her individual home. There is a split of authority as to whether individual owners can sue for defects in the common areas under the control of an association. Some jurisdictions would permit individual owners to bring suit against the developer for defects in the common areas, while other jurisdictions have held that associations have the exclusive right to bring suit for defects in the common areas.

Class Actions

A class action provides a means by which one or more individuals may sue as representatives of a large group of persons who are interested in the outcome of a legal controversy. Class actions are particularly useful where members of the class are so numerous as to make it impractical to bring them all before the court as party-plaintiffs. Not surprisingly, class actions are often utilized with regard to lawsuits brought against community associations or developers on behalf of numerous owners.

Defenses a Developer Can Assert as to Suits Brought by Community Associations or Individual Owners Based on Alleged Construction Defects

1. Statutes of Limitations. A statute of limitations prescribes the time limitations within which a cause of action must be brought. A cause of action will be barred if not brought within the applicable statute of limitations. Different causes of actions often have different limitations periods. The applicable statutory limitations period within which a particular type of claim must be brought will vary from state to state.
2. **Statutes of Repose.** While a statute of limitations dictates the timeframe in which a plaintiff may bring suit after a cause of action accrues, a statute of repose completely extinguishes a cause of action after a fixed period of time regardless of when the cause of action accrues. Usually, a statute of repose begins to run upon the completion of the work or the delivery of a product.

3. **Avoidable Consequences/Mitigation of Damages Defense.** A failure to mitigate damages is an affirmative defense available to a developer in an action brought by a community association to recover for construction defects. Pursuant to this doctrine, an association that suffers a loss has a duty to make a reasonable attempt to mitigate its damages. If the community association fails to make a reasonable attempt to mitigate its damages, the developer will not be liable for damages that could have been avoided by reasonable prudence and care.

**Necessity of Competent Legal Counsel**

Competent legal representation of a community association will go a long way toward supporting a smooth and seamless turnover of control from the developer-appointed directors to the homeowner-elected representatives. The developer’s attorney is involved in drafting the governing documents and the sales documents, registering the community (as required by various federal, state, and local laws and ordinances), processing sales, and otherwise counseling the corporate entity that is responsible for the actual development and, possibly, construction of the project.

The developer’s attorney should encourage the developer to fulfill its contractual obligations and to respond promptly to punch list items and owner inquiries. The attorney should also follow up on any compliance issues related to construction and development.

It is not appropriate for the developer’s attorney to also represent the community association. There is too much potential for conflict of interest, as the rights and concerns of the owners diverge from the business interests of the developer. All association directors, on pre- and post-transition boards, have a fiduciary duty to the membership that requires them to place the interests of the association and its members ahead of their personal interests. Some state laws hold developer-appointed directors to a higher standard of duty and care, and attach significant personal liability to breach of that duty.

Prior to transition, the association attorney must make sure that the association board meets the documentary and statutory requirements for regular and special member board meetings, keeping of minutes, maintenance of financial records, rosters, and so on. Beyond the procedural and legal requirements, there are steps to be taken to lay the groundwork for the eventual transition of the association. The association attorney should encourage the developer-board to involve the owners in the governance process through two basic steps.

**Step 1: Communication.** The association attorney should make sure meeting notices are posted or distributed to all owners. Working with the professional manager, the attorney can assist in the creation of a newsletter or other type of regular communication between the board and the owners. Working with the accounting professional, the association attorney can make sure that legally required financial statements are produced and distributed, and that the financial records are kept in accordance with
applicable laws. The flow of information bears a direct relationship to the degree of membership satisfaction. Both the attorney for the developer and the attorney for the developer-controlled association should encourage the developer to be available to the buyers and owners as the sales and build-out progress. When owners feel that the developer representatives are available to them and are willing not only to listen but also to be responsive, the owners develop more confidence and trust in the transition process.

**Step 2: Gradual Evolution of Self-Government.** The attorney for the developer should produce an initial set of documents that include the appointment of a committee made up of non-developer owners, perhaps at the point at which 50 percent or so of the dwellings have been sold. The committee would attend board meetings and could be used to assist the developer-board in operating the association, enforcing the documents, developing rules, and the like.

The association attorney can assist the committee members in understanding the governing documents, the rights and responsibilities of the individual owners, and the respective roles of the developer, the board, the manager, and the owners. Such a committee could also assist with annual meetings, help with the orientation of new owners and residents, and be used to provide experience in governance for eventual non-developer board members. The association attorney should train committee members regarding the scope of board authority, the duty to maintain the common property, and statutory and documentary procedural requirements. As time for turnover of the association draws near, this group can become the transition committee.

At the turnover meeting, the association attorney can preside over and facilitate the election of the non-developer directors. The attorney would also assist in the organizational meeting of the board at which the association officers are elected. Because the association attorney does not represent the developer, he or she is in a position to answer questions and educate the owners on the legal aspects of transition. Once the owners other than the developer have taken over governance responsibilities, the association attorney’s obligation is to guide the board through the process of preserving and protecting the legal rights of the association and its members.

As part of the board’s fiduciary duty to maintain, repair, and replace common property, the board should arrange for a professional inspection of any property for which it is responsible. A report from a professional architect or engineer will bring to light any construction issues. In addition, it can serve as a basis for short- and long-term planning for the maintenance of common property and the establishment and funding of reserve accounts.

The association attorney should be involved in reviewing and negotiating the contract, in reviewing the report with the architect or engineer, and in addressing the issues raised with the developer. The professional community association manager can assist in the evaluation process, working with the board and the association attorney to collect owner surveys and coordinate repairs and access to the common property for contractors if work has to be done.

In addition, the board has a duty to protect the common funds. It is appropriate for the association attorney to recommend that the post-transition board engage the services of an accounting professional to review the association’s financial records. Some state laws require a final report or an audit to be produced by the developer at the time.
of transition. There may also be working capital accounts and reserve account funding issues. The developer may owe assessments or other charges. Again, the attorney should review the contract as well as the final financial report for the accounting professional.

**How to Avoid or Minimize the Risk of Litigation**

With the rapidly increasing popularity of community associations, a cadre of specialists has evolved who are available to help owner boards navigate the transition from developer to owner control so as to properly discharge their fiduciary duty to their constituents. These professionals include managers, attorneys, engineers, and accountants who are knowledgeable within their respective areas of expertise and can provide constructive assistance in achieving a successful transition.

Simultaneously, developers have become increasingly aware of the potential for liability to community associations for defects in the common property and for financial mismanagement. The more progressive, therefore, have endeavored to establish procedures of their own to help effect a smooth transition to owner control and to minimize their potential liability. These include the engagement of independent counsel and accountants for the association at an early stage of transition, usually no sooner than the first transition election when 25 percent of the units have been sold. Just as importantly, professional management companies are often retained by developers at the outset to manage association affairs and maintain the common property. Some of these management companies are independent, while others are affiliated with the developers. Affiliated management firms are not as effective a shield against liability, because they can be held liable for the improper discharge of their duties. However, regardless of whether the management company is independent, the developer is still exposed to claims for improper maintenance and administration of the association during the period of developer control. Nevertheless, practices such as these can be most effective to foster a level of confidence and trust among owners that often is non-existent when the developer-controlled board does not try to establish the association as a discrete entity that functions independently of the developer and its consultants.

Perhaps the two key principles to be observed by both developers and owners in attempting to effect a successful transition are to communicate effectively with the other side and to avoid litigation except as a last resort. In the first instance, this means that, beginning with the date of the first closing, the developer should understand and assume the initiative to educate the owners about the role and operation of the association. Further, the owners should be involved as soon as possible in association activities through committee operations, newsletters, public forums, and other appropriate means. The lines of communication must be kept open at all times between the developer and the owner leadership, especially during the critical stages of transition negotiations. Far too often, one or both sides communicate solely through their attorneys or other professional consultants, which may promote an adversarial relationship rather than one of mutual understanding.

With respect to the avoidance of litigation, it doesn’t take much experience to understand that in today’s world of high legal fees, the cost of prosecuting or defending practically any relatively simple case between an association and a developer will reach
five figures for each party well before trial, if it is complicated and vigorously contested, such as a construction-defect case, a seven-figure fee for each side’s attorney is not uncommon. Expert fees also substantially increase the total costs for all parties. Clearly this money would normally be much better spent by both sides to help remedy any real problems that exist with respect to the physical property maintained by the association, or to fund future reserves, rather than in pursuing expensive lawsuits with uncertain results over an extended period of time. Therefore, litigation should be a last resort only after there has been a total breakdown in constructive communication. Even then, after the issue is joined, the parties and their attorneys should continue to re-establish a positive dialogue and attempt to settle the material claims as early as possible in the litigation process. However, it must be recognized that, as a practical matter, serious settlement negotiations in standard construction claims cannot take place without an exchange of expert reports. Therefore, the sooner these reports are obtained, the greater the potential for an earlier settlement. Moreover, it is important for the association board to completely weigh both the merits of its claims and the economics of litigation before authorizing litigation, even though it may be recommended by its attorney, who may not be totally objective.

The Extended Sales Period
Transition can be relatively easy where a community association sells out rapidly and the owners assume control of the board within a short period of time after the majority close title. The property to be maintained by the community association remains relatively new and is still under warranty, and the owners are busy decorating their new homes and meeting their neighbors, rather than focusing on grievances with the developer or the association.

However, in a very large or slow-selling development where there is a considerable time lapse until the turnover of control to the owners, problems are likely to develop. Specifically, the physical property deteriorates and the warranty periods expire while the developer-controlled board is responsible for maintenance, and when the owners finally assume control they often expect the commonly maintained property to be in "as new" condition.

Logically these factors dictate either an earlier turnover of control or a process by which the developer can achieve a legally binding release of its warranty and related construction responsibilities while remaining in control of the board. However, there are legal and practical constraints on both approaches. For example, although it is theoretically possible to provide for an earlier surrender of control in the association’s governing documents, there may be statutory or regulatory constraints that impede or prevent this. There are statutory and regulatory provisions that protect the developer to a limited extent from actions by the association that would adversely and materially affect the marketing or completion of the development or lower the standards of maintenance.

In addition to legal restrictions, several very real practical problems face the developer in providing for any early transfer of control. Specifically, almost every developer would be very reluctant to make itself prematurely vulnerable to the power of an owner-controlled association if it would result in substantially increased financial risk.
A developer also would want to be assured that the governing documents or a separate agreement with the association, approved by a majority of the owners, adequately protects its rights to complete the project without additional financial risk.

As to achieving release from warranty and other obligations without having to wait until turnover of control at the 75-percent sales benchmark, if the developer is still in control of the association board, it seems unlikely that any release executed on behalf of the association would be binding unless it was ratified by a majority vote of owners and based on independent legal and technical advice provided by experts selected by the owner representatives. There is no legal precedent for this scenario, and it would probably be harder to achieve than an early surrender of control of the executive board. Whether early release is achieved, independent engineering inspections of the physical property as improvements are completed might be very useful to the developer in defending any subsequent claims for defective construction. Most importantly, such inspections can enable the developer to assert timely warranty claims against subcontractors, alleviating a very real practical problem in which construction-defect claims are not addressed until months or years later, when the owners assume control of the community association.

**The Selection of Independent Counsel for the Association**

A delicate issue that faces every developer and its attorney during the transition process is the selection of an independent attorney. Both the developer board members and the developer's counsel have an inherent conflict of interest when and if they must address matters bearing on the relationship between the developer and the association, such as warranty and construction defect issues. However, there are different constraints on their respective roles.

Developer board members have a fiduciary duty to the members of the association to exercise a prudent business judgment on behalf of the association notwithstanding such conflict. In practice, however, it is more likely that (1) the developer-controlled board takes no action at all that would be adverse to the developer, (2) the developer representatives abstain when such an issue arises, or (3) the rights and claims of the association against the developer are preserved for the record in the minutes of the association.

On the other hand, counsel for the developer has ethical constraints against acting on behalf of the association in any matter where its interests are adverse to the developer. These conflicts may appear with increasing frequency as the association matures and more owners move in. It is a serious mistake for the developer's counsel to represent the association in any capacity at any time, because in any subsequent litigation between the association and the developer there is a very real risk that the developer's attorney would be disqualified from representing either side. Accordingly, it is recommended that the developer's attorney never represent the association and that he limit his advice to matters dealing with the administration of the association. In addition, all legal fees for work on association-related matters should be billed directly to the developer, who may, but probably should not, seek reimbursement from the association. Further, the developer's attorney should state in writing to the association that he represents the developer only, not the association.
This inherent conflict dictates that the association obtain independent counsel as soon as possible—notwithstanding the reluctance of most developers to introduce a potential adversary into the scenario, especially as the developer will be responsible for a significant portion of the fees unless a transition fund has been established to cover this expense with contributions from each purchaser at closing. There are two ways to solve this problem. The first and most common is to select independent general counsel for the association; the other, less frequent method is to retain ad hoc special counsel as conflicts arise between the developer and the association. Although the latter approach may initially seem less threatening and more economical to the developer, it is not necessarily either.

Generally, selecting an independent general counsel for the association is the preferred method of dealing with conflicts. Most owner board members will begin to lobby for an independent association attorney soon after the first transition election, when 25 percent of the sales have occurred, particularly if the developer-controlled board is not responding properly to owner grievances or is not managing the association properly. Sometimes political reasons alone will fuel the pressure to have separate counsel for the association. Often, however, because the developer has a propensity to resist this idea for the reasons previously stated, either no independent counsel will be retained during the period of developer control, or, if an independent attorney is retained, it tends to occur much closer to the 75-percent sales benchmark and the surrender of control to the owners.

The postponement of the selection of independent counsel is not necessarily in the best interest of the developer. Independent counsel presence can help increase the comfort level of owners and help build and maintain communication bridges with the developer, especially if the attorney's approach is conciliatory rather than adversarial.

As for the method of selecting an association attorney during developer control, perhaps the best way is to let the owner members of the board choose from a list of qualified attorneys identified by the developer or the managing agent. The developer should approve the attorney selected, for if he is not acceptable to the developer or not qualified, his selection may not be a constructive step for the association and will certainly impede the transition process. Similarly, if the developer selects the attorney without involving or getting the approval of the owner representatives on the board, it is often counterproductive because of the stigma attached to the attorney and the resulting negative impact on his credibility.

**The Role of Government Agencies in the Transition Process**

Sometimes it is sound practice for an association or its attorney to report to the state regulatory agencies if a developer is not responsive to a major transition problem. However, caution should be exercised not to contact such agencies prematurely, as this likely will be viewed by the developer as a hostile act and impede future communication with the developer. On the other hand, where little or no communications previously existed, contact with state officials may serve as a vehicle for getting the developer's attention. Therefore, an association should be judicious about involving state regulators in the transition process.
Another technique that is sometimes used effectively by transitioning associations to seek redress from the developer is to enlist the help of municipal officials in obtaining developer compliance with construction obligations. Municipalities usually have the authority to require the posting of both performance and maintenance guarantees with regard to improvements in subdivisions and to refuse to release the guarantees until there has been approval of the improvements. However, there are certain legal limitations on the powers of a municipality. It is clear that if defects exist in site improvements, which have been bonded, the municipality has the right to seek correction of those defects or to assert claims under the bonds, not releasing them until the improvements have been completed to the satisfaction of the municipal engineer.

The statutory and regulatory provisions for the progressive surrender of control accomplish their purpose in protecting a developer’s investment in a project and affording owner representatives the opportunity to gain knowledge and experience in the operation of their association before assuming full responsibility. Further, these laws help ensure that the developer will not prematurely abdicate its responsibility to the owners and permit them to flounder with respect to the discharge of association duties. However, these same requirements, when used overzealously by some professional consultants, have helped create an adversarial climate that is not in the best interests of either developers or associations. In addition, the process does not address the problems inherent in large developments or those where sales are slow and the surrender of control may not occur for several years. These problems include the developer’s warranty obligations for completed improvements, owner anxieties about assuming control, and complications that evolve from the developer’s conflict of interest when it remains in control.

Many of the practical problems discussed are the result of regulatory inadequacies, while others are the result of poor communication between the developer and owner representatives regarding association concerns. It is hoped that a process will evolve that will address some of the more important issues raised, so the transition from developer to owner control can be a cooperative and constructive experience with the primary beneficiaries being the parties themselves rather than their professional consultants.

**Engineering Reports and Punch Lists**

In recent years it has been a common practice for the initial owner-controlled boards of community associations to commission an engineering inspection of the property, which the association is obligated to maintain in order to fulfill the board’s fiduciary duty to the owners. If an association elects to avail itself of the entire scope of services recommended, the resultant reports generally have several distinct components. These include (1) a description of the condition of the physical property, (2) a capital reserve study, (3) a recommended maintenance schedule, and (4) a comparison of the actual construction with the approved plans and applicable codes. In reality, only the first three elements are necessary to discharge the board’s fiduciary responsibility to maintain the property; the plan and code comparison focuses mostly on the possibility of potential claims against the developer. Nevertheless, most reports are all-inclusive. It is important that a new owner-controlled board understands the relevance of the engineering report to the transition process and particularly to the responsibility of
the developer. Far too often this report is viewed and utilized indiscriminately, imped-
ing transition negotiations with respect to the developer’s construction and warranty responsibilities. Problems commonly arise as follows:

**The physical condition of the property.** First, it is recommended that a description of the physical condition of the property focus on the major items and not list every minor defect to be found. However, the latter approach is understandable given the engineer’s concern about liability for oversight. Frequently, the engineer or the association’s attorney does not take the time to edit the initial report in order to distinguish between significant and minor problems. As a result, when the developer and its attorney are presented with the report, the minor problems (such as birds’ nests in the gutters and minor cracking in the concrete) obscure the essential areas to be addressed, and the credibility and good faith of the association are impugned. There is a school of thought that the parties should spend their time and effort negotiating away the smaller items before addressing the ones that count. Sounder principles of negotiation, however, suggest that if the more important issues are addressed at the outset, there is a greater chance for a successful resolution of all the problems. Otherwise, there is a very real risk that the negotiations will flounder or the parties will polarize over the details of the lesser matters, and the problems that truly count will never be addressed. Accordingly, it is recommended that the association or its consultants give priority to the major physical defects included in the engineer’s report, separating them from the minor ones in an independent portion or summary of the report as well as during negotiations.

**Failure of the engineering report to discern between construction defects and the lack of proper maintenance** is a related problem. A developer generally has warranty responsibility for the former, but it does not necessarily follow that a developer-controlled board is liable for maintenance problems. This is especially true in associations where an independent management company is responsible for the physical maintenance and where minority owner board members have participated in the selection of the company or have not objected to its performance during the period of developer control. Further, if the maintenance of the project was deficient during this time, it does not logically follow that the developer or its appointed board members should bear the entire financial burden of remediﬁng the maintenance deﬁciencies. If this were the case, then the developer would have a similar claim against the owner board members individually for the cost of remediﬁng any maintenance deﬁciencies that occurred after the owners assumed control, which is certainly not the case.

The foregoing discussion is not intended to suggest that maintenance deﬁciencies should not be identiﬁed in the engineering report. Obviously they must be addressed by the owner-controlled board in light of the engineer’s recommendation and the proposed schedule of maintenance. But, unless the maintenance deﬁciencies are clearly sepa-

**The reserve study** is another component of the engineering report that is frequently misconstrued. Uninformed, owner-controlled boards and developers are often led to believe that the developer is liable whenever the reserve study prepared by the asso-
Association’s engineer shows that a greater amount should be set aside for capital repair and replacement than the amount originally included in the reserve component of the budget that was incorporated in the public-offering statement. This is not necessarily the case.

First, there is often no governmentally imposed or generally recognized standard as to what should be provided in the reserve budget when it comes to items, useful lives, or even amounts to be included. Therefore, if the public-offering material contains an independent letter of adequacy as to the reserves and another expert subsequently retained by the owners has a different opinion as to what constitutes an adequate reserve schedule, it does not necessarily follow that the developer is at fault. (See Reserve Funds, published by CAI for different approaches to the establishment of reserves.) Experts will have varying opinions as to what is adequate. This is not to suggest, however, that the developer is not responsible to fund the capital reserves provided for in the public-offering plan.

Comparison of construction with applicable plans and codes. With respect to the comparison between the actual construction and the approved plans, specifications, and relevant codes, there are several problem areas. One is the expectation that is created among owners that there should be monetary compensation or that the construction should be brought into conformance with the approved documents or applicable codes regardless of the nature of the discrepancy. This reaction is understandable, but it fails to take into consideration factors such as field changes necessitated by unexpected conditions during construction, any approvals by governmental inspectors and agencies of such changes, alternative methods of compliance with codes, if any, and, finally, the impact of such variations on the durability and usefulness of the project improvements at issue. Clearly, where there is a serious health or safety problem, or a substantial economic issue such as significantly higher maintenance costs, the association should seek to hold the developer accountable. However, far too frequently owner-controlled associations assert that they are entitled to redress for every such discrepancy and run the risk of impeding an effective dialogue with the developer regarding the major problems. For instance, does it really matter if the landscaping is in a different location or if the species vary from the approved plan if the maintenance costs and aesthetics are generally comparable? The focus should be on items that count, such as fire-safety measures, structural soundness, and so forth.

Finally, a related topic is the use of punch lists, of which there are two general types. The first is a list in abbreviated form of all of the defects set forth in the engineer’s report. Commonly this is prepared by the owner-controlled board’s or the developer’s engineer and is used as a tool to facilitate dialogue between owners and the developer. Although it has worked effectively in many instances, such a punch list also can detract from the discussion of any major problems that may exist.

The other type of punch list summarizes the results of a questionnaire submitted to owners by the owner-controlled board or its engineer. This instrument solicits input from owners as to any defects that they perceive to exist in the common elements appurtenant to their home, and often goes so far as to solicit input about defects in their homes. Unfortunately, this punch list does not and cannot take into account such factors as the difference between construction and maintenance defects, the lapse of war-
ranty periods, or the materiality of the defect. Therefore, although some engineers will defend such a document as necessary to identify every problem in their exercise of due diligence, this type of questionnaire can have a significant negative effect on transition negotiations if it is given to the developer without appropriate editing. More importantly, it frequently creates an expectation among owners who expect that any items that they list ultimately will be remedied by the developer or the association. When they are not, it is often much more difficult for an owner-controlled board to garner the support of its constituents. Accordingly, this type of punch list should be used with caution and with appropriate admonitions to the owners as to its purpose and relevance.

To summarize, engineering reports and punch lists commissioned by owner-controlled boards should be used judiciously and their purpose and impact should be understood. To transmit engineering reports to a developer in an unedited form and without having established priorities can impede constructive dialogue. Also, it should be kept in mind that the engineer who writes the reports ultimately may have to back them up with testimony in court, therefore, the content of the reports and the engineer’s experience and record as an expert witness are very important. Above all, an owner-controlled board should keep in mind that the best engineering report is a clean engineering report. Accordingly, if the board receives a good report from a competent engineer, it should resist any suggestion to shop around for a less favorable report that could help fuel questionable claims and litigation from which neither side usually benefits.

**Insurance**

The purpose of this section is to provide general insurance guidance—including purchasing responsibilities and timelines—to those involved in the development, sponsorship, and organization of community associations. Insurance provides protection for losses throughout the transition process, so the parties involved do not suffer any adverse financial losses or pass on a loss to someone else.

**Flood Insurance**

Although flood insurance is available through other sources, this section will concentrate on the National Flood Insurance Program (NFIP), residential condominiums, and the use of the appropriate Standard Flood Insurance Policy forms and rating system. When reviewing this section, please keep in mind that only those eligible properties located in participating communities qualify for NFIP coverage. For an explanation of building eligibility and community participation, visit the NFIP Web page at www.fema.gov/nfip.

The Standard Flood Insurance Policy (SFIP) has three forms: the general property form, the dwelling form, and the residential condominium building association policy (RCBAP) form. Which form will apply is determined by the building's type of ownership and occupancy. These same two factors are also essential in deciding the amount of the flood insurance policy premium. The dwelling form is used to insure a single-family or two-to-four family dwelling, as well as a single-family dwelling in a condominium building. It also is used to insure residential contents. The general property form is used to insure other residential or non-residential buildings and/or their contents. The
RCBAP insures a residential condominium building and commonly owned contents of the association, as well as all units within the building. To qualify for an RCBAP, at least 75 percent of the total floor area must be residential.

The builder/developer must initially purchase coverage under the Condominium Association Policy (CAP) rating system using the general property form. Once the developer has sold a minimum of two units, the CAP may be rewritten using the RCBAP rating system and form. The intended occupancy area of the building must have 75 percent of its floor space devoted to residential use.

The developer and/or sponsors, upon legal conveyance of ownership to the association, may transfer the existing RCBAP into the name of the association, or the association may purchase a new policy. The association is then responsible for purchasing and maintaining insurance coverage. It is imperative that the building be insured to at least 80 percent of its replacement cost. Policy limits should be reviewed annually and whenever any improvements have been made to the buildings. Should the policy limits fall below 80 percent of the building’s replacement cost, the association will be considered a coinsurer, and a coinsurance penalty will be applied at the time of a flood loss. Owners who have purchased flood insurance on their individual units (under a SFIP dwelling form) will not be provided loss assessment coverage if the association has failed to maintain the 80-percent replacement cost figure and has experienced a flood loss. If no RCBAP is in effect at the time of the loss, coverage under the dwelling form will respond to any flood-related loss assessment levied against the owner.

Owners may purchase individual flood insurance policies on their units. They may do so to fulfill a requirement by their lender, or to insure those items within the unit not otherwise covered by the association policy. Such items might include structural improvements made by the owner or the owner’s personal property. The SFIP form used to insure an individual residential condominium unit is the dwelling form, which also allows for loss assessment coverage provided that the RCBAP insuring the association has a policy limit of at least 80 percent of the building’s replacement cost, or if there is no RCBAP in existence.

Cooperatives may purchase coverage under the general property form of the SFIP. As these residential buildings are not in the condominium form of ownership, they do not qualify for the RCBAP. A cooperative building, in which at least 75 percent of the area of the building is used for residential purposes, is considered as residential occupancy. Cooperative buildings are to be insured under the general property form. Once ownership of the building has been turned over to the association, coverage may be purchased by the association. An owner in a cooperative building does not qualify for building coverage through the NFIP. However, individuals may purchase flood insurance on their personal property.

Property Insurance Other Than Flood Insurance
This section is provided to address all types of property coverage other than flood insurance for a given community association. Responsibilities for securing the various types of property insurance will also be highlighted. The broad term “property insurance” includes, but is not limited to, special form buildings and contents, equipment and

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machinery, earthquake, building law/ordinance, and backup of sewers and drains. All coverages should meet the minimum standards set by statutory law and the association's governing documents.

For additional information on other types of coverage, such as HOA without Residential Coverage or Cooperatives, please see Developer Transition, published by CAI.

**Condominium & Homeowners Associations With Residential Coverage**
The developer must initially provide property insurance on all completed common-area buildings, structures, and contents until a master policy can be written in the name of the association. Property insurance on residential buildings must be secured until the first conveyance of title to an owner within a building under construction. At the time of this conveyance the building will be added to the association's policy, but the developer should continue to carry a builders risk or installation floater until all construction is completed for the residential building in question. The builders risk or installation floater also would be used to cover common-area buildings until their completion.

Once a master policy can be written, the completed common-area buildings, structures, and contents should be covered by the association's master policy. Coverage for the completed value of the residential buildings should be added to the association's master policy at the time of the first owner conveyance within a residential building. Most often the coverage will be written on a single-entity basis, which means the units within a building will be insured to replace or repair the units to the same kind and quality as originally offered or built by the developer. Alterations, additions, improvements, betterments, and upgrades done by owners that go beyond the developer's specifications would not be insured by the association.

Owners should purchase their property insurance through a homeowner's six policy (HO6) or an equivalent. Property insurance that should be considered by owners typically include personal contents, improvements, betterments, alterations, additions, upgrades, property loss assessment, and enough unit coverage to assume the association's master policy deductible.

**Fidelity Insurance and Directors & Officers Liability**
From the moment the association is a legal entity it should purchase both fidelity and directors & officers (D&O) liability coverage. These coverages should carry the association from the period when the association board is totally developer-controlled to the final transition to an all-owner board. All coverages purchased should meet the minimum standards set by statutory law and the association itself. The fidelity insurance may also be subject to Fannie Mae guidelines of having a limit equal to three months operating budget plus the entire reserve account.

**Workers Compensation**
The developer should have workers compensation coverage provided for all workers involved in the development of the association. This should be separate and distinct from the association's workers compensation; from the moment it is a legal entity, the association should have its own workers compensation policy. This policy should be purchased whether or not the association has its own employees, as the association...
could be responsible for workers compensation benefits to someone it does not consider its own employee.

**Liability Coverages**
The coverages considered in this section include, but are not limited to, General Liability, Automobile Liability, Employment Practices Liability, and Umbrella policies. These coverages must be purchased to meet the minimum standards set by statutory law and the association’s governing documents. The developer should purchase liability coverages for the entire time period their representatives are on site. The association’s liability policy should be separate and distinct. The developer’s policy should cover all construction and development operations the developer/sponsor controls.

Community associations should have liability coverage the minute they become a legal entity. Only the operations of the community association should be covered by these liability policies. Construction operations should be covered by the developer’s coverage. Owners should purchase their own liability coverage. The association’s policy does provide some limited coverage to owners, but this is only while they are performing an act related to the operations of the association. To have proper coverage, the owner should secure their own liability coverage. This liability coverage is commonly offered under a Homeowners 3 (HO3), Homeowners 6 (HO6), or their equivalents.

**SECTION SIX**

**Who Are the Parties?**

**The Association**
The association operates much like a municipal body in the sense that it is governed by an elected board that represents the interests of its members. It is important to understand that transition is the process of assuming responsibility for the governance of the association and that it is not limited to dealing with construction issues, as is oftentimes thought. Transition begins very early, with the establishment of the association as an entity, governed by representatives initially appointed by the builder. Homeowner members of the association become actively involved with the transition process after the first election meeting, at which typically one or two members of the association are elected to a board of directors.

Following the initial election, the homeowner members of the board begin to become familiar with the governing process as outlined in the documents of the association. While at this stage they typically represent a minority interest on the board, they nonetheless are responsible as board members for conducting business on behalf of those they represent—the homeowners. Their responsibility includes hiring professional advisors, bidding and awarding contracts for services provided to the association, establishing and enforcing rules and restrictions as permitted by the governing documents, and insuring the proper operation and administration of the association. At this
point in the transition process, the association begins to take on a profile or personality, because rules and regulations, policies and procedures, and architectural control issues begin to evolve with the input and influence of the homeowner board members.

Further into the development process, typically after 75 percent of the homes to be built have been conveyed to homeowners, another election is held. Following this election, homeowners will represent a majority interest on the board, with the developer usually maintaining a minority vote (or sometimes a non-voting seat on the board). It is common at this point for the board to begin hiring a professional team to conduct the investigations related to the board’s due diligence. This team should include a manager, an independent accounting firm, an attorney, and an engineer, all of whom will play a significant role in the transition process.

The focus of transition at this stage is more specifically on what the builder has provided. The board’s responsibility to the association is to ensure that the promises of the builder as outlined in the public offering have been fulfilled. It is important at this juncture to differentiate association issues from homeowner issues. The board will commonly receive input from homeowners concerning issues related to their individual units rather than the common elements. Individual homeowner issues must be handled directly by the homeowners themselves, in conjunction with warranties that have been provided. The board should focus on what is commonly owned by all homeowners—the common elements—as defined in the master deed or declarations.

The best practice is to retain a manager first because the manager will coordinate the efforts of the other professionals. The manager also can be expected to have valuable input regarding other local professionals that might be most effective in the specific circumstance of the association. When considering professional management, the board will want to consider the incumbent manager hired by the developer or alternative managers in the area. The advantage of retaining the incumbent lies to a large degree in the base of knowledge this manager has regarding issues that have been identified since the beginning of the manager’s tenure. The downside of retaining the incumbent rests primarily in the perception that he was hired by the builder and may harbor a continuing affiliation that could cause a conflict of interest. This issue should be examined carefully, inasmuch as it is often a perception as opposed to a reality.

Other professionals that should be considered at this point include an independent accountant, an engineer, and an attorney. Once all of the professionals have been retained, the board might appoint a subcommittee of two or three individuals to deal directly with the manager and other professionals on transition-related matters.

If a subcommittee is appointed, it should have an established structure for regularly reporting back to the board regarding its progress. Once a refined set of reports is established, the full board should review and approve them and submit them to the developer for comment. From this point forward, the full board should maintain close communication and monitoring of the negotiation process (assuming that issues for developer action have been identified), utilizing its subcommittee and professional advisers to conduct the actual discussions. Once all parties are in agreement as to the resolution of any identified issues, the full board should accept the resolution and execute any necessary documents as provided by legal counsel.
The primary role of the board, therefore, can be summarized as one of reviewing information, directing professional advisers, and making decisions regarding the transition process. These decisions relate not only to construction and accounting matters, but to governance, administrative, and operational issues as well.

**The Manager**

The professional manager plays a very important role in the transition process, ranging from assisting in the education of new board members with regard to the association’s governing process, to coordinating the work of the professional team retained by the board. Heavy reliance should also be placed on the manager to assist in establishing and maintaining timelines for the production of reports, reviewing information, and refining any issues that might be identified.

Perhaps the manager's most critical job is to provide a realistic context for the board that ensures any expectations concerning transition are reasonable. Once again, the transition process includes not only investigating construction issues but also the evolution of the governing process, fine-tuning of rules, regulations, and restrictions, development of architectural control standards, and establishment of administrative policies that will serve the community into the future. A professional manager will be able to analyze the administrative and operating systems of the association and point to what is missing or what can be further fine-tuned. In terms of developer-related issues, the manager should play a key role in providing focus for the association, so a realistic list of concerns can be identified and managed.

One of the first responsibilities of the manager following what is commonly referred to as the transition election is to make sure that the board has its professional advisers in place. The manager will be familiar with the extent of any potential issues in the community and know other professionals in the area who have experience with transition matters. The manager consequently will be in a position to recommend several professionals for the board to interview. In this process, it is best to limit candidates being interviewed to a maximum of three for each category— independent accountant, engineer, and attorney. If desirable, proposals can be solicited from five or six candidates, from which three can be selected for interview. The manager will be able to coordinate this process, so the board can make its choice in an organized and informed atmosphere.

Once the professional team is established, the manager should work with the board and each professional to develop timelines for the production of reports. Once established, the manager will monitor progress so the timelines are maintained, and receive the draft reports for distribution to the board, its subcommittee, and the association’s legal counsel.

Due to the nature of the manager's responsibility for the day-to-day administration of the association, he will come across a wide variety of issues, some of which may be related to studies being conducted by the engineering and accounting firms. The manager should maintain a list of such issues and include them in any related investigation that is conducted.

Once the draft engineering report and auditor's report are received, the board or its subcommittee should review it and refine any issues that have been identified. Here
again, the manager can provide a valuable service to the association by maintaining realistic expectations and keeping the board or subcommittee focused on the important issues at hand. When final reports are produced and furnished to the developer, the manager will assist in scheduling meetings and discussions, so the process of resolving any identified issues does not become overly protracted.

All in all, the manager is much like an orchestra conductor, bringing together skilled musicians of varying types to produce a symphony that is fulfilling to those he represents. This is done by establishing the context, creating the team, coordinating the efforts, refining the result, and resolving the issues.

**The Approving Authorities**

At the time that a project is conceived and permitted, there is no owner's agent representing the interest of the future association. So, to some degree, the approving authorities provide some oversight. The developer appears before various local, state, and federal agencies to secure the necessary approvals for the design, specifications, and construction practices for the project.

These agencies are charged with protecting the public interest, which may or may not coincide with the future owners’ interests. Generally speaking, a public agency enforces standard codes and specific regulations of the state or local government. These standards protect the health and welfare of the community and assure a minimum level of structural integrity. By enforcing these standards, the approving agency is providing minimal representation for the owners’ interest.

The project approval process may also include negotiated standards. These standards are not hard and fast, rather they may provide certain concessions or inducements for the developer to proceed as an “essential” community development project. For example, the municipality might grant a developer a lower specification for road construction, trash storage space, or buried utilities, because they are privately owned on the project site. In return, the developer might agree to receiving reduced municipal services. The outcome of these negotiations, while favorable to the approving authority and the developer, often is not in the best interest of the future owners. For example, future owners may bear an undue municipal-tax burden for a lower level of public services, or be prohibited from negotiating public assistance for repair of roads that have become public thoroughfares.

During the construction phase, agents of the approving authority charged with the enforcement of codes and standards make periodic inspections of the property to make sure that the project is proceeding in accordance with standards, designs, and specifications. Ultimately, the approving authority will issue a certificate of occupancy based on these periodic and final inspections. Critical parts of the inspection include, but are not limited to, plumbing, electrical, fire-safety, and energy codes. While code-enforcement inspections can assure that the project meets major standards (design approval of the architect’s or engineer’s plans) and some smaller details (polarity of outlets) they may miss substantial defects (for example, substituted water-service fittings that corrode more rapidly or obstructed eave ventilation that leads to ice dams).
In some jurisdictions, municipal leaders have adopted enabling legislation for planned urban developments. In some cases, the municipality has the power to grant approving-authority status to the developer. The developer then will oversee the builder’s compliance with codes and, with the municipality, issues certificates of occupancy. During transition and discussion of construction defects, the approving authority can be involved as a disinterested party. The certificate of occupancy is an important document. On occasion, owners allege that the approving authority and its agent, the code-enforcement officer or inspector, is negligent for accidentally or willfully overlooking code violations during construction inspections.

In the final analysis, the approving authorities have two substantial effects on the outcome of transition and the community’s future well-being. First, through negotiated agreements and concessions, they set the stage for conditions that future owners might consider project shortcomings and defects. Second, diligent code enforcement brings a considerable amount of information to the transition discussion, and has the potential to detect and eliminate faults during construction.

SECTION SEVEN
Emerging Strategies to Discourage Litigation

Developers of community associations have become increasingly concerned over the years with their exposure to liability for construction defects. They are particularly troubled by the proliferation of protracted lawsuits that are perceived as unnecessary or spurious. Frequently these lawsuits are initiated by the boards of directors rather than by individual owners. Accordingly, governing document innovations and legislative initiatives have been undertaken to promote settlement or avoid such litigation altogether.

Specifically, drafting techniques are being developed and utilized to expand the boundaries of units to include as much of the physical property as possible, with a corresponding reduction in the scope of the common elements and common property. These provisions minimize the role of the association in enforcing construction warranties by shifting the standing and authority to enforce such warranties from the association to individual owners.

Another approach that is being pursued both in the drafting of governing documents and through legislation passed in California and introduced in Maryland is the establishment of a procedural process that is condition precedent to the commencement of any construction litigation. A similar approach is included in the current draft of UCIOA proposed for New Jersey. In every case, the goal is to discourage boards from arbitrarily filing such lawsuits without informing and, in some cases, obtaining the informed consent of the owners. Mediation or non-binding arbitration also may be required.
In addition to innovations dealing with governing documents and legislature, there are also a number of developers who are implementing in-house procedures for minimizing the risk of defect and budgetary litigation with the review and coordination of the design documents, budgets, and as-built construction. These developers have also found it to be beneficial to have subcontractors correct any deficiencies before they receive their final payment and leave the project.

A comprehensive risk-management program such as this would take place at the completion of the architectural and engineering drawings, and continues through the completion of construction, when the owners take control of the association. It would include:

1) A review of the design drawings to confirm coordination between the architectural and engineering designs at the interface points between the two. A typical example is the discharge of the roof drains (downspouts), which are shown on the architectural drawings, and the site grading and drainage, which are shown on the engineering plans.

2) A review of the description of the community included within the governing documents for conformance to the actual final design shown on the architectural and engineering drawings.

3) A review of the budget included within the governing documents to confirm that the reserve study accurately represents the materials and quantities shown on the design drawings, and that the cost of maintenance for the common and limited common elements is also accurately reflected.

4) A review of the as-built construction as it is taking place to confirm that it is in general conformance with the design documents. In some cases, punch lists are also developed at this time to be given to the subcontractors for repair before they leave the site.

5) A review of the final as-built construction immediately prior to the owners' taking control, so the potential for extensive transition report punch lists are minimized.

Although the approaches are varied, they all share the goal of ensuring that owners participate in the decision process, rather than having it made behind closed doors by the board and the association's attorney.
SECTION EIGHT

Attachments

Sample Condominium Transition Agreement and Release

THIS AGREEMENT made by and between the ____________________________ Condominium Association, Inc., a [State] Corporation, with offices at ____________________________ (hereafter, the “Association”) and at ______________________ a [State] Corporation, with offices at ____________________________.

WHEREAS, ____________________________ is the developer of a condominium community located in the ____________________, __________________, State, known as ____________________________ (hereafter, the “Condominium”), and

WHEREAS, the Association is responsible for, and maintains the common elements and property of the Condominium and represents the concerns of individual unit owners of the Condominium with respect to such common elements, and

WHEREAS, various disputes have arisen between ____________________________ and the Association concerning certain repairs to and conditions of said common elements of the Condominium, and

WHEREAS, representatives of the Association and ____________________________ have met on numerous occasions to discuss resolution of disputed issues between the Association and ____________________________ arising out of the development of the Condominium, and

WHEREAS, the Association received and delivered to ____________________________ engineering reports prepared by ____________________________ dated ____________________________ (the “Engineer’s Reports”), and

WHEREAS, numerous letters and supplemental reports have been delivered by both ____________________________ and the Association, and

WHEREAS, subsequent to the issuance of the Engineer’s Reports, ____________________________ and the Association conducted walkthroughs of the Condominium in an effort to narrow and resolve the outstanding issues between them, and

WHEREAS, the Association and ____________________________ desire to resolve this matter and mutually release each other from any and all claims regarding the repair or construction of the Condominium, provided, however, all conditions enumerated below are complied with;
NOW, THEREFORE, in consideration of the mutual promises contained herein, ______________________ and the Association agree as follows:

1. ______________________ agrees to perform all work more particularly described in Exhibit A, attached hereto and incorporated herein. This work shall be completed within the time frames more specifically set forth in Paragraph 5.

2. ______________________ agrees to make a one-time contribution of $_________ to the Association. This settlement amount will be paid within 30 days from the date this Agreement is signed.

3. **Release:**
   The Association hereby absolutely releases and discharges __________________, and any of __________________ subsidiaries, subcontractors, affiliates, agents and related entities and any and all past and present officers, directors, shareholders, agents, subcontractors, or employees of any said entities, including but not limited to __________________ any of the __________________, any subsidiary of any of the foregoing entities and any and all former members of the board of directors of the Association (“Board” heretofore designated by __________________ or otherwise selected to serve on the Board on behalf of ______________________ in their individual capacities (all such __________________ related entities and persons shall hereafter collectively be referred to as the “____________________”) from and against any and all liabilities, damages, promises, covenants, agreements, causes of action, judgments, claims, or determinations in law or in equity or any costs or expenses including but not limited to attorney’s fees, arising from or in connection with any and all claims which the Association, and its members (as claims of such members relate to the common elements themselves and not to claims arising from the Purchase Agreement or the individual unit) shall or may have against __________________ and/or __________________, and particularly any and all claims arising out of or asserted, whether, or not involving actions taken or not by __________________ and/or the __________________, in connection with (i) the approval and creation of the Condominium, (ii) the preparation, approval and satisfaction of the documents required for its creation, including but not limited to any Public Offering Statements filed in [State], any amendments thereto, the plans and/or specifications referred to therein or related to the Condominium and the land use documents, (iii) the construction, repair and maintenance of the Condominium, (iv) the management of the Association monies including any reserve funds, and (v) any other matter for which __________________ and/or the __________________ might be responsible in connection with the Condominium including but not limited to:

   (A) Any and all defects in the Condominium, whether latent or patent, and whether now existing or hereafter arising or discovered, including any deviation from applicable building codes;

   (B) Any deviations between the plans and specifications referred to in the Public Offering Statement, amendments thereto and exhibits thereto, or on file with any governmental agency, and the Condominium as actually constructed;
(C) Any deviations between the plans, including site plans and amendments there-
to, for the Condominium referred to in documents filed with any applicable planning
board or board of adjustment or on file with any building department, building official
or any other governmental agency including but not limited to, use or bulk variances,
parking requirements, construction plans, etc.

(D) Any and all claims asserted or arising out of or in connection with any matters
set forth in any reports prepared by ____________________ or any representatives or
employees of that firm, any documents referred to in those reports, and/or any other
engineers or consultants engaged by the Association.

(E) Any and all warranties, whether express or implied, including but not limited
to any warranties under the [State] New Home Warranty and Builders Registration
Act, and the Planned Real Estate Development Full Disclosure Act. Notwithstanding
the above, to the extent that the 10-year warranty as to major structural defects pro-
vided by a third party insurer has not yet expired, same shall be unaffected by this
release, but only as to the rights against such insurer.

(F) The turnover of documents pursuant to the [applicable state statute].

4. Simultaneous with the signing of this Agreement, the Association shall also
adopt a resolution (attached as Exhibit B) by which the Board of Trustees authorizes
the execution of this Agreement and Release, and ratifies the settlement of this matter.

5. Subject to weather conditions and the availability of materials,
_________________ will commence all repairs, replacements or improvements
as specified above within 30 days of the execution of this Agreement. Within 180
days of signing this Agreement, Developer will complete all repairs, replacements or
improvements as specified above, unless, by its terms, such repairs or improvements
are not to be made or completed until some time later.

6. __________________ will provide the Association with an express warranty for
a period of twelve (12) months as to the quality of workmanship and materials for the
work set forth in Exhibit A. This warranty shall commence upon written notification
from ____________________ that the work is complete. Developer is not providing
any implied warranties to the Association. The Association shall have one (1) year
from the expiration of the aforesaid warranty to commence an arbitration or civil
action against Developer, or forever release ____________________ from any such
claims pursuant to the warranty.

7. It is the intent of the Agreement and Release that both parties waive and relin-
quish their claims concerning any and all defects or deficiencies, alleged or real,
reported or not, discovered or not, except as provided in the ten (10) year warranty as
to major structural repairs as set forth in Paragraph 3(E).

8. Should any work or matter set forth in this Agreement in an amount not
to exceed Fifty Thousand ($50,000) Dollars, not be completed or resolved to the
mutual satisfaction of ____________________ and the Association, such dispute shall
be resolved by binding arbitration in accordance with the rules of the American
Arbitration Association with an arbitrator as to responsibility, methods and cost
allocation. Such ruling shall be binding upon both parties and may be reduced to
judgment. Any dispute concerning an amount in excess of Fifty Thousand ($50,000)
Dollars may only be arbitrated upon the mutual written agreement of the parties.
9. Upon completion of all work as set forth in this Agreement, ________________ and the Association shall have no further responsibility to each other with regard to the development and creation of the Community, except as provided in the ten (10) year warranty as to major structural repairs as set forth in Paragraph 3(E).

10. The Association shall use its best efforts to assist ________________ in securing a final release of the bonds posted with the municipality for public improvements as set forth in connection with all approved site plans. Upon completion and acceptance by Association's engineer of the work under this Agreement, the Association agrees not to assert any objections to the release of the bonds by the municipality.

11. This Agreement and the Exhibits attached hereto shall not constitute an admission of liability or serve as evidence of liability on the part of ________________ and/or any related entities.

12. The Association accepts the promises and covenants set forth in the Agreement in full satisfaction and discharge of all rights and/or claims now and forever due and owing.

13. This Agreement shall be binding upon all successor Boards of Trustees for the Association, its successors and/or assigns.

14. This Agreement including the Exhibits attached hereto contains the entire agreement between the parties as to the settlement of their disputes and no amendment, modification or addendum to this Agreement shall be effective unless in writing dated subsequent to the date hereof and executed by the duly authorized officers of the respective parties. The requirement for such a writing shall apply to any waiver of the requirement of a written modification pursuant to this Paragraph and shall be deemed an essential term of the Agreement.

IN WITNESS WHEREOF, the parties have set their hands and seals this ________ day of ________________, 20____.

ATTEST: CONDOMINIUM ASSOCIATION, INC.

______________________________ BY: ________________________________
Secretary President

ATTEST:

______________________________ BY: ________________________________
Secretary
Sample List of Documents to be Turned Over

Declarant should deliver these documents—some are mandated by state law:

- Certified copy of the declaration, as amended, and all supplements
- Association’s corporate records and rules and regulations
- Association’s funds or control of those funds
- All personal property of the association
- Copies of the plans/specifications used in the construction of the common elements
- All insurance policies and warranties in effect
- Copies of all certificates of occupancy issued for common elements
- All other governmental permits
- Warranties in effect
- A roster of names, addresses and phone numbers of owners and mortgagees
- Employment and service contracts
- Documentation supporting all meetings
- Documentation regarding covenant enforcement and design review
- Resignations of declarant members of executive board and officers
- Certificate of good standing from the secretary of state
- Signature cards and banking resolutions for money accounts
- Prior years’ and current budgets
- All state and federal income tax returns
- Tax identification numbers
- Information regarding all service suppliers
- Documentation regarding all liens and claims of the association

What the board should do:

Physical and common elements “audit”

- Determine the condition of the common elements and other physical portions of the community through appropriate engineering or contractor inspections
- Confirm with legal counsel that association owns all common elements
- Compete new or review existing reserve study
- Take a hard look at assessments and budgets—are they sufficient

Organizational “audit”

- Corporate audit for association
- Governing document review—will these work for the association?
- Covenant enforcement audit for issues of breach of covenants, design review, consistency in enforcement, status of claims, possible waiver issues
SECTION NINE

Additional Resources

Books available from CAI


For more information or a CAI Press catalog, please call (888) 224-4321 (M-F, 9-6:30 ET) or visit www.caionline.org.

Other Books of Interest

Best Practices Reports (available at www.cairf.org):
Community Harmony & Spirit
Community Security
Energy Efficiency
Financial Operations
Governance
Green Communities
Reserve Studies/Management
Strategic Planning
Transition
About the National Association of Home Builders (NAHB)

NAHB exists to represent the building industry by serving its members and affiliated state and local builders associations. To achieve an overall mission of member satisfaction, NAHB concentrates on the following goals:

• Balanced national legislative, regulatory and judicial public policy.
• Public appreciation for the importance of housing and those who provide it.
• The premier resource for industry information, education, research and technical expertise.
• Improved business performance of its members and affiliates.
• Effective management of staff, financial, and physical resources to satisfy the association’s needs.

NAHB strives to create an environment in which:

• All Americans have access to the housing of their choice and the opportunity to realize the American dream of homeownership.
• Builders have the freedom to operate as entrepreneurs in an open and competitive environment.
• Housing and those who provide it are recognized as the strength of the nation.

To find out more about NAHB, visit www.nahb.org or call 800-368-5242.
About the Foundation for Community Association Research
The Foundation provides authoritative research and analysis on community association trends, issues and operations. Our mission is to inspire successful and sustainable communities. We sponsor needs-driven research that informs and enlightens all community association stakeholders—community association residents, homeowner volunteer leaders, community managers and other professional service providers, legislators, regulators and the media. Our work is made possible by your tax-deductible contributions.

Your support is essential to our research. Visit www.cairf.org or e-mail foundation@caionline.org.

About Community Associations Institute (CAI)
Community Associations Institute (CAI) is an international membership organization dedicated to building better communities. With more than 32,000 members, CAI works in partnership with 60 chapters, including a chapter in South Africa, as well as with housing leaders in a number of other countries, including Australia, Canada, the United Arab Emirates and the United Kingdom. CAI provides information, education and resources to the homeowner volunteers who govern communities and the professionals who support them.

CAI members include association board members and other homeowner leaders, community managers, association management firms and other professionals who provide products and services to associations. CAI serves community associations and homeowners by:
• Advancing excellence through seminars, workshops, conferences and education programs, most of which lead to professional designations for community managers and other industry professionals.
• Publishing the largest collection of resources available on community association management and governance, including website content, books, guides, Common Ground™ magazine and specialized newsletters.
• Advocating on behalf of common-interest communities and industry professionals before legislatures, regulatory bodies and the courts.
• Conducting research and serving as an international clearinghouse for information, innovations and best practices in community association development, governance and management.

We believe homeowner and condominium associations should strive to exceed the expectations of their residents. We work toward this goal by identifying and meeting the evolving needs of the professionals and volunteers who serve associations, by being a trusted forum for the collaborative exchange of knowledge and information, and by helping our members learn, achieve and excel. Our mission is to inspire professionalism, effective leadership and responsible citizenship—ideals reflected in associations that are preferred places to call home. Visit www.caionline.org or call (888) 224-4321.
DEVELOPING FUNCTION-SPECIFIC BEST PRACTICES
in the community association industry has been a goal of Community Associations Institute and the Foundation for Community Association Research for several years. The Foundation has developed best practices in select topic areas using a variety of sources, including, but not limited to, recommendations from industry experts and various industry-related publications. The outcomes of the Best Practices project include:

• Documented criteria for function-specific best practices.
• Case studies of community associations that have demonstrated success in specific areas.
• A showcase on community excellence.